



EIILM UNIVERSITY
S I K K I M

BUSINESS ENVIRONMENT

Subject: BUSINESS ENVIRONMENT

Credits:4

SYLLABUS

Overview of Business Environment

Concept; Meaning; Nature of Business Environment; Business Today; Types of Environment; Competitive Structures of Industries; Competitor Analysis; Environment- Business Relation; Environmental Analysis Process; Importance of Environmental Analysis

Economic Systems and Political Environment

Economic System; Kinds of Economic System; the Flows of Economic Activity; Basic Problems of an Economy and the Role of Government; Political System; Function of State, Classification of Functions of State; Politico-Economic Synthesis

Economic Transition in India: Privatization and Globalization

Introduction; Privatization: Objects, Privatization Routes, Benefits, Criticisms, Conditions for Success; Privatization in India; Privatization Policy; Types & Drawbacks of Privatization; Globalization; Reasons for Globalization ; Features & Stages of Globalization; Drawbacks of Globalization; Globalization Impact on Indian Economy

Consumer Rights, Consumerism and Business

Introduction to Consumer Rights; the 8 Consumer Rights; Consumer Responsibility; Consumer Protection in India; Exploitation of Consumers; Plight of the Indian Consumer

Business and Society

Social Environment: Poverty and Poverty Alleviation Programs, Labor and Employment, Women in the Workforce, Child Labor, Education, Health, Population and Family Welfare; Corporate Governance; Corporate Social Responsibilities; Business Ethics

Business Law Part – I

Law of Contract (Indian Contract Act, 1872); Consideration & Competence to Contract; Performance and Discharge of Contracts; Contract of Agency

Business Law Part – II

Partnership Act, 1932; Sales of Goods Act, 1930; Law of Insurance; the Negotiable Instruments Act, 1881.

Company Law Part – I

Nature of Company and Formation; Memorandum and Article of Association; Prospectus; Statement in Lieu of Prospectus; Share and Share Capital;

Company Law Part - II

Debentures; Company Management and Remuneration; Meeting and Resolutions; Account and Audit, Prevention of Oppression, and Mismanagement; Winding Up.

Suggested Readings:

1. Business Environment by Saleem Shaikh, Publisher: Pearson Education
2. Business Environment by Justin Paul, Publisher: The McGraw Hill Companies
3. Business Environment: Text and Cases by Francis Cherunilam, Publisher: Himalayan Publishing House
4. Business Environment by K. Chidambaram and V. Alagappan, Publisher: Vikas Publishing House Pvt. Ltd.
5. Labor Relations Law in India by Agarwal, S.L., Publisher: Macmillan Company of India Ltd. New Delhi
6. Industrial Law by Mallick, P.L., Publisher: Eastern Book Company, Lucknow
7. Labor and Industrial Laws by Misra, S.N., Publisher: Pioneer Publications, Delhi.
8. Aspects of Labor Welfare and Social Security by Sarma, A.M., Publisher: Himalaya Publishing House: Bombay.
9. Corporate Strategy on Fringe Benefits by Thakur, C.P., Publisher: Spectrum Publishing House: Delhi.
10. The Business Environment by Ian Worthington and Chris Britton, Publisher: Prentice Hall

OVERVIEW OF BUSINESS ENVIRONMENT

Structure

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1.1 CONCEPT, MEANING, NATURE OF BUSINESS ENVIRONMENT

Meaning of Business Environment

Business Environment consists of all those factors that have a bearing on the business, such as the strengths, weaknesses, internal power relationships and orientations of the

organization; government policies and regulations; nature of the economy and economic conditions; sociocultural factors; demographic trends; natural factors; and, global trends and cross-border developments.

Concept of Business Environment

A business firm is an open system. It gets resources from the environment and supplies its goods and services to the environment. There are different levels of environmental forces. Some are close and internal forces whereas others are external forces. External forces may be related to national level, regional level or international level. These environmental forces provide opportunities or threats to the business community. Every business organization tries to grasp the available opportunities and face the threats that emerge from the business environment.

Business organizations cannot change the external environment but they just react. They change their internal business components (internal environment) to grasp the external opportunities and face the external environmental threats. It is, therefore, very important to analyze business environment to survive and to get success for a business in its industry. It is, therefore, a vital role of managers to analyze business environment so that they could pursue effective business strategy. A business firm gets human resources, capital, technology, information, energy, and raw materials from society. It follows government rules and regulations, social norms and cultural values, regional treaty and global alignment, economic rules and tax policies of the government. Thus, a business organization is a dynamic entity because it operates in a dynamic business environment.

Nature of Business

Business may be understood as the organized efforts of enterprise to supply consumers with goods and services for a profit. Businesses vary in size, as measured by the number of employees or by sales volume. But, all businesses share the same purpose: to earn profits.

The purpose of business goes beyond earning profit. There are:

- ❖ It is an important institution in society.
- ❖ Be it for the supply of goods and services.
- ❖ Creation of job opportunities.
- ❖ Offer of better quality of life.
- ❖ Contributing to the economic growth of the country.

Hence, it is understood that the role of business is crucial. Society cannot do without business. It needs no emphasis that business needs society as much.

1.2 BUSINESS TODAY

Modern business is dynamic. If there is any single word that can best describe today's business, it is change. This change makes the companies spend substantially on Research and development (R & D) to survive in the market. Mass production and mass marketing

are the norms followed by business enterprises. The number of companies with an annual turnover of Rs.100 crore each was only three in 1969-70. The figure has gone up by hundreds these days.

Today's business is characterized by diversification, which may be:

Concentric Diversification - It refers to the process of adding new, but related products or services.

Horizontal Diversification - Adding new, unrelated products or services for present customers is called horizontal Diversification.

Conglomerate Diversification - It refers to adding new and unrelated products or services. Going international is yet another trend followed by modern business houses.

Business houses are exposed to global competition, which argues well for consumers. Also occupying a major role is science in the global economic scenario.

1.2.1 Business in 21st Century

Large organizations, with a large workforce will not exist. They will be 'Mini' organizations. Business during the 21st century will be knowledge-based; tomorrow's manager need not spend his time on file pushing and paper-shuffling. Information technology will take care of most of that work. Organizations will become flat. Linear relationship between the boss and manager and authority flowing downwards and obedience upward will disappear. Employees will have no definite jobs. Most of the jobs will last for two to five years. Remuneration will depend on one's contribution to organization.

1.2.2 Business Goals

Profit - Making profit is the primary goal of any business enterprise.

Growth - Business should grow in all directions over a period of time.

Power - Business houses have vast resources at its command. These resources confer enormous economic and political power.

Employee satisfaction and development - Business is people. Caring for employee satisfaction and providing for their development has been one of the objectives of enlightened business enterprises.

Quality Products and Services - Persistent quality of products earns brand loyalty, a vital ingredient of success.

Market Leadership- To earn a niche for oneself in the market , innovation is the key factor.

Challenging- Business offers vast scope and poses formidable challenges.

Joy of creation- It is through business strategies new ideas and innovations are given a shape and are converted into useful products and services .

Service to society - Business is a part of society and has several obligations towards it .

1.3 TYPES OF ENVIRONMENT

On the basis of the extent of intimacy with the firm, the environmental factors may be classified in to different types or levels. As indicated BELOW, there are, broadly, two types of environment, the internal environment, *i.e.*, factors internal to the firm and external environment, *i.e.*, factors external to the firm which have relevance to it.

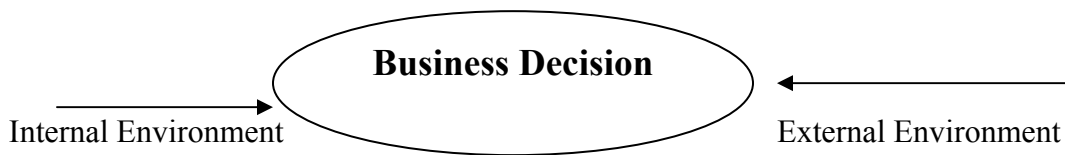


Fig 1.1 Factors Influencing Business Decision

The internal factors are generally regarded as **controllable factors** because the company has control over these factors; it can alter or modify such factors as its personnel, physical facilities, organization and functional means, such as marketing mix, to suit the environment.

The external factors, on the other hand, are, by and large, beyond the control of a company. The external or environmental factors such as the economic "factors, socio-cultural factors, government and legal factors, demographic factors, geo-physical factors etc; are, therefore, generally regarded as uncontrollable factors.

It may, however, be noted that a firm may not sometimes have complete control over all the internal factors. Also, it is some times possible to change certain external factors.

Some of the external factors have a direct and intimate impact on the firm (like the suppliers and distributors of the firm). These factors are classified as micro environment, also known as task environment and operating environment. There are other external factors which affect an industry very generally (such as industrial policy demographic factors etc). They constitute what is called macro environment, general environment or remote environment.

Although business environment consists of both the internal and external environments, many people often confine the term to the external environment of business.

1.3.1 Internal Environment

The important internal factors which have a bearing on the strategy and other decisions are outlined below.

Value System

The value system of the founders and those at the helm of affairs has important bearing on the choice of business, the mission and objectives of the organization, business policies and practices. It is a widely acknowledged fact that the extent to which the value system is shared by all in the organization is an important factor contributing to success. The value system of JRD Tata and the acceptance of it by others who matter were responsible for the voluntary incorporation in the Articles of Association of TISCO its social and moral responsibilities to consumers, employees, shareholders, society and the people.

After the EID Parry group was taken over by the Murugappa group, one of the most profitable businesses (liquor) of the ailing Parry group was sold off as the liquor business did not fit into the value system of the Murugappa group.

The value system and ethical standards are also among the factors evaluated by many companies in the selection of suppliers, distributors, collaborators etc.

Vision, Mission and Objectives

The business domain of the company, priorities, direction of development, business philosophy, business policy etc., is guided by the vision mission and objectives of the company.

Ranbaxy's thrust in to the foreign markets and development has been driven by its mission "to become a research based international pharmaceutical company. Arvind Mills' mission - "To achieve global dominance in select business built around our core competencies through continuous product and technical innovation, customer orientation and focus on cost effectiveness", - has driven its future development strategy including the portfolio strategy, and indicated the thrusts required in the functional areas to help achieve the mission.

Management Structure and Nature

The organizational structure, the composition of the Board of Directors, extent of professionalisation of management etc., are important factors influencing business decisions. Some management structures and styles delay decision making while some others facilitate quick decision making.

The Board of Directors being the highest decision making body which sets the direction for the development of the organization and which oversees the performance of the organization, the quality of the Board is a very critical factor for the development and

performance of company. The private sector in India presents extreme cases in this respect. At one end there are companies with highly qualified and responsible Board and at the other end there are companies which do not possess these qualities.

The share-holding pattern could have important managerial implications. There are very large companies where majority of the share is held by the promoters (like Wipro) and there are large firms where the promoters' position is very vulnerable (like the Tata group of companies).

Financial institutions had large share holding in many Indian companies. The stand of nominees of financial institutions could be very decisive in several critical instances.

Internal Power Relationship

Factors like the amount of support the top management enjoys from different levels of employees, shareholders and Board of Directors have important influence on the decisions and their implementation.

The relationship between the members of Board of Directors and between the chief executive and the Board are also critical factors.

Human Resources

The characteristics of the human resources like skill, quality, morale, commitment, attitude etc., could contribute to the strength -and weakness, of an organization. Some organizations find it difficult to carry out restructuring or modernization because of resistance by employees whereas they are smoothly done in some others.

The involvement, initiative etc., of people at different levels may vary from organization to organization. The organizational culture and overall environment have bearing on them. John Towers, M.D., Rover Group, observes that a Japanese company of 30,000 employees is 30,000 process improvers. In a Western company, it is 2,000 process improvers and 28,000 workers. And in an Indian company?

Company Image and Brand Equity

The image of the company matters while raising finance, forming joint ventures or other alliances, soliciting marketing intermediaries, entering purchase or sale contracts, launching new, products etc. Brand equity is also relevant in several of these cases.

Miscellaneous Factors

There are a number of other internal factors which contribute to the business success/failures or influence the decision-making. They include the following.

1. Physical Assets and Facilities like the production capacity, technology and efficiency of the productive apparatus, distribution logistics etc., are among the factors which influence the competitiveness of a firm. **For example**, as quality is very important in the pharmaceutical industry, particularly for a global player, in the case of Core Healthcare

not only there is no compromise on quality but also the company made the quality norms stricter than international or other relevant standards and the quality mantra has been well imbibed throughout the organization.

2. R & D and Technological Capabilities, among other things, determine a company's ability to innovate and compete.

3. Marketing Resources like the organization for marketing, quality of the marketing men, brand equity and distribution network have direct bearing on marketing efficiency. They are important also for brand extension, new product introduction etc.

4. Financial Factors like financial policies, financial position and capital structure are also important internal environment affecting business performances, strategies and decisions.

1.3.2 External Environment

As stated earlier, the external business environment consists of a micro environment and a macro environment.

Micro Environment

"The micro environment consists of the actors in the company's immediate environment that affects the performance of the company. These include the suppliers, marketing intermediaries, competitors, customers and the publics." The macro environment consists larger societal forces that affect all the actors in the company's micro environment namely, the demographic, economic, natural, technical, political and cultural forces."

It is quite obvious that the micro environmental factors are more intimately linked with the company than the macro factors. The micro forces need not necessarily affect all the firms in a particular industry in the same way. Some of the micro factors may be particular to a firm. **For example**, a firm which depends on a supplier may have a supplier environment which is entirely different from that of a firm whose supply source is different. When competing firms in an industry have the same' micro elements, the relative success of the firms depends, *inter alia*, on their relative effectiveness in dealing with these elements.

Suppliers

An important force, in the micro environment of a company is the suppliers, *i.e.*, those who supply the inputs like raw materials and components to the company. The importance of reliable source/sources of supply to the smooth functioning of the business is obvious. Uncertainty regarding the supply or other supply constraints often compels companies to maintain high inventories causing cost increases. It had been pointed out that factories in India maintained indigenous stocks of 3-4 months and imported stocks of 9 months as against an average of a few hours to two weeks in Japan.⁴ The liberalization,

however, has caused a significant change in the situation.

Because of the sensitivity of the supply, many companies give high importance to Vendor development. Vertical integration where feasible, helps to solve the supply problem. *For example*, Nirma has always been a believer of the logic" that captive production plants for raw materials is the best way to production costs in check and it has gone for a mammoth backward integration. In many cases, however, outsourcing is more beneficial. It is very risky to depend on a single supplier because a strike, lock out or any other production problem with that supplier may seriously affect the company. Similarly, a change in the attitude or behavior of the supplier may also affect the company. Hence, multiple sources of supply often help reduce such risks.

The supply management assumes more importance in a scarcity environment. "Company purchasing agents are learning how to "wine and dine" suppliers to obtain favorable treatment during periods of shortages. In other words, the purchasing department might have to "market "itself to suppliers."

Recognizing the critical importance of the supply factor, companies all around the world are increasingly resorting to partnering / relationship marketing.

Customers

As it is often exhorted, the major task of a business is to create and sustain customers. A business exists only because, of its customers. Monitoring the customer sensitivity is, therefore, a prerequisite for the business success.

A company may have different categories of consumers like individuals, households, industries and other commercial establishments, and government and other institutions. **For example**, the customers of a tyre company may include individual automobile owners, automobile manufacturers, public sector transport undertakings and other transport operators.

Depending on a single customer is often too risky because it may place the company in a poor bargaining position, apart from the risks of losing business consequent to the winding up of business by the customer or due to the customer's - switching over to the competitors of the company.

With the growing globalization, the customer environment is increasingly becoming global. Not only that the markets of other countries are becoming more open, the Indian market is becoming more exposed to the global competition and the Indian customer is becoming more "global" in his shopping.

Competitors

A firm's competitors include not only the other firms which market the same or similar products but also all those who compete for the discretionary income of the consumers. **For example**, the competition for a company's televisions may come not only from other

T.V manufacturers but also from two-wheelers, refrigerators, cooking ranges, stereo sets and so on and from Firms offering savings and investment schemes like banks, Unit Trust of India, companies accepting public deposits or issuing shares or debentures etc. This competition among these products may be described as **desire competition** as the primary task here is to influence the basic desire of the consumer. Such desire competition is generally very high in countries characterized by limited disposable incomes and many unsatisfied desires (and, of course, with many alternatives for spending/investing the disposable income).

If the consumer decides to spend his discretionary income on recreation (or recreation cum education) he will still be confronted with a number of alternatives to choose from like T.V., stereo, two-in-one, three-in-one etc. The competition among such alternatives which satisfy a particular category of desire is called **generic competition**.

If the consumer decides to go in for a T.V., the next question is which form of the T.V black and white or Colour with remote control or without it etc. In other words, there is a **product form competition**. Finally, the consumer encounters the **brand competition** *i.e.* the competition between the different brands of the same product form.

An implication of these different demands is that a marketer should strive to create primary and selective demand for his products.

Consequent to the liberalization, the competitive environment in India has been undergoing a sea change. Many companies restructured their business portfolio and strategies. In many industries where a seller's market existed a buyer's market has emerged.

Marketing Intermediaries

The immediate environment of a company may consist of a number of marketing intermediaries which are "firms that aid the company in promoting, selling and distributing its goods to final buyers".

The marketing intermediaries include middlemen such as agents and merchants who "help the company find customers or close sales with them", physical distribution firms which "assist the company in stocking and moving goods from their origin to their destination such as warehouses and transportation firms; marketing service agencies which "assist the company in targeting and promoting its products to the right markets such as advertising agencies, marketing research firms, media firms and consulting firms; and financial intermediaries which finance marketing activities and insure business risks.

Marketing intermediaries are vital links between the company and the final consumers. A dislocation or disturbance of the link, or a wrong choice of the link, may cost the company very heavily. Retail chemists and druggists in India once decided to boycott the/products of a leading company on some issue such as poor retail margin. This move far collective boycott was, however, objected to by the MRTP Commission; but for this the company would, perhaps, have been in trouble. Hindustan Lever too faced major challenge when it faced a collective boycott in Kerala on the issue of trade margin.

Financiers

Another important micro environmental factor is the financiers of the company. Besides the financing capabilities, their policies and strategies, attitudes (including attitude towards risk), ability to provide non-financial assistance etc. are very important.

Publics

A company may encounter certain publics in its environment. A public is any group that has an actual or potential interest in or impact on an organization's ability to achieve its interests. Media publics, citizen's action publics and local publics are some examples.

Macro Environment

A company and the forces in its micro environment operate in a larger macro environment of forces that shape opportunities and pose threats to the company. The macro forces are, generally, more uncontrollable than the micro forces. When the macro environment is uncontrollable, the success of a company depends on its adaptability to the environment. *For example*, if the cost of the imported components increases substantially because of the depreciation of the domestic currency, a solution may be their domestic manufacture.

Important macro environment factors include economic environment, political and regulatory environment, social/cultural environment, demographic environment, technological environment, natural environment, and global environment.

a) Technological Environment

Technology is understood as the systematic application of scientific or other organized knowledge to practical tasks. Technology changes fast and to keep pace with it, businessmen should be ever alert to adopt changed technology in their businesses.

b) Economic Environment

There is close relationship between business and its economic environment. Business obtains all its needed inputs from the economic environment and it absorbs the output of business units.

c) Political Environment

It refers to the influence exerted by the three political institutions viz., legislature executive and the judiciary in shaping, directing, developing and controlling business activities. A stable and dynamic political environment is indispensable for business growth.

d) Natural Environment

Business, an economic pursuit of man, continues to be dictated by nature. To what extent business depends on nature and what is the relationship between the two constitutes an interesting study.

e) Global or international Environment

Thanks to liberalization, Indian companies are forced to view business issues from a global perspective. Business responses and managerial practices must be fine-tuned to survive in the global environment.

f) Social and culture Environment

It refers to people's attitude to work and wealth; role of family, marriage, religion and education; ethical issues and social responsiveness of business.

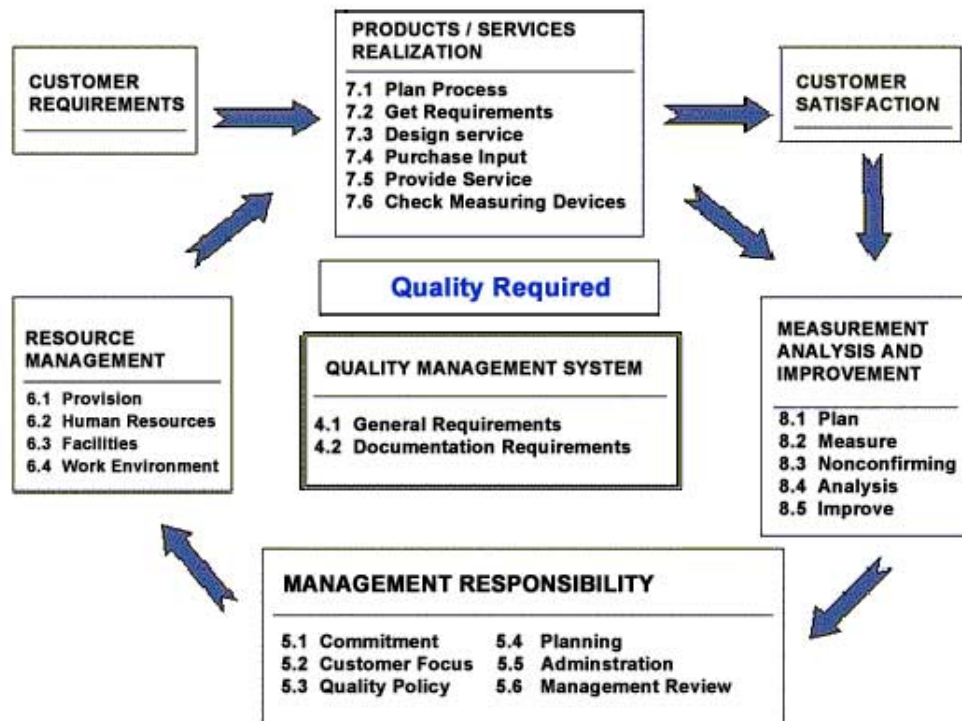


Fig 1.2 Business Environment

1.4 COMPETITIVE STRUCTURE OF INDUSTRIES

The Competitive structure of industries is a very important business environment. Identification of forces affecting the competitive dynamics of an industry will be very useful in formulating strategies.

According to Michael Porter's well known model of structural analysis of industries, the state of competition in an industry depends on five basic competitive forces, viz.

1. Rivalry among existing firms
2. Threat of new entrants
3. Threat of substitutes
4. Bargaining power of suppliers
5. Bargaining power of buyers.

Fig. 1.3 depicts the five forces competitive structure of industry. The diagram is a slightly modified presentation of the one provided by Porter. The arrows in the diverse directions indicate opposing forces. *For example* just as the buyers and suppliers may have bargaining power over the firm, the firm may also have some bargaining power over the buyers and suppliers.

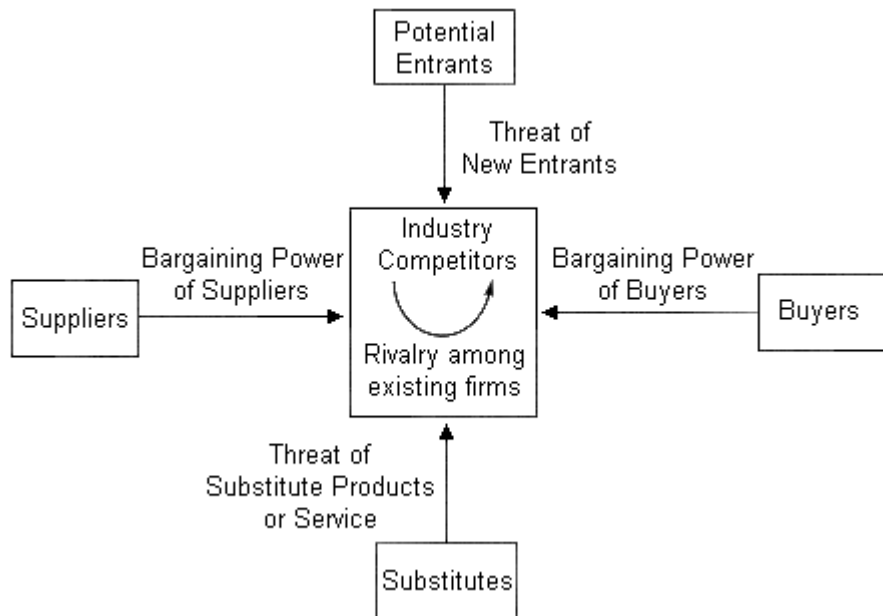


Fig 1.3 Five Force competitive Structure of Industry

Threat of Entry

A growing industry often faces threat of new entrants that can alter the competitive environment. There may, however be a number of barriers to entry. Potential competition tenor to be high if the industry is profitable or critical, entry barriers are low and expected.

The following are some of the important common entry barriers:

- 1. Government Policy:** In many cases government policy and regulation are important entry barriers. *For example*, prior to the economic liberalization in India, government dictated entry barriers were rampant, like reservation. of industries products for public sector and small scale sector, industrial licensing, regulations under MRTP Act, import restrictions, restrictions on foreign capital and technology etc.
- 2. Economies of Scale:** Economies of scale can deter entry in two ways: it keeps out small players and discourages even potentially large players because of the risk of large stakes.
- 3. Cost Disadvantages Independent of Scale:** Entry barrier may also arise from the cost advantages, besides that of economies of scale, enjoyed by the established firms which cannot be replicated by new firms, such as proprietary product technology, learning or experience curve, favorable access to raw materials, favorable location, government subsidies etc.
- 4. Product Differentiation:** Product differentiation characterized by brand image, customer loyalty, product attributes etc. may form an entry barrier forcing new entrants to spend heavily to overcome this barrier.
- 5. Monopoly Elements:** Proprietary product / technology, monopolization / effective control over raw material -supplies, distribution channels etc. are entry barriers which are insurmountable or difficult to overcome.
- 6. Capital Requirements:** High capital intensive nature of the industry is an entry barrier to small firms. Further, the risk of huge investment could be a discouraging factor even for other firms.

Rivalry among Existing Competitors

Rivalry among existing competitors is often the most conspicuous of the competitions. Firms in an industry are "mutually- dependent" - competitive moves of a firm usually affects others and may be retaliated. Common competitive actions include price changes, promotional measures, customer service, warranties, product improvements, new product introductions, channel promotion etc.

There are a number of factors, which influence the intensity of rivalry. These include:

- 1. Number of Firms and their Relative Market Share, Strengths etc.:** Rivalry is likely to be affected by the number firms, their relative market shares, competitive strengths, etc.
- 2. State of Growth of Industry:** In stagnant, declining and, to some extent, slow growth industries a firm is able to increase its sales only by increasing its market share, *i.e.*, at the expense of others.

3. Fixed or Storage Costs: When the fixed or storage costs are very high, firms are provoked to take measures to increase sales for improving capacity utilization or reducing storage costs.

4. Indivisibility of Capacity Augmentation: Where there are economies of scale, capacity increases would be in large blocks necessitating, in many cases, efforts to increase sales to achieve capacity utilization norms.

5. Product Standardization and Switching Costs: When the product of different firms is standardized, price, distribution, after-sales service, credit etc. become important strategic variables of competition. Absence of switching costs makes firms more vulnerable.

6. Strategic Stake: Rivalry in an industry becomes more volatile if a number of firms have high stakes in achieving success there. *For example*, a firm which regards a particular industry as its core business will give great importance to success in that industry.

7. Exit Barrier: High exist barriers. (*For example*, compensation for labor, emotion! attachment to the industry etc.) tend to keep firms competing in an industry even though the industry is not very attractive.

8. Diverse Competitors: Rivalry becomes *more* complex and unpredictable when competition are very diverse in their strategies, origins, personalities, relationships to their parents etc

9. Switching Costs: In some cases a barrier to entry is created key switching costs (i.e., on time costs facing the buyer of switching from one supplier's product to another's) such as cost of retraining the employees, cost of new ancillary equipment etc.

10. Expected Retaliation: The potential entrants' expectations about the reactions of the existing competitors may also sometimes deter entry.

Threat of Substitutes

An important force of competition is the power of substitutes. Substitutes limit the potential returns in an industry by placing a ceiling on the price firms in the industry can profitable charge. The more attractive the price performance alternative offered by substitutes, the firmer the lid on industry profits.

Firms in many industries face competition from those marketing close or distant substitute. Porter points out that substitute products that deserve the most attention are those that (1) are subject to trends improving their price-performance trade off with the industry's product, or (2) are produced by industries earning high profits.

Bargaining Power of Buyers

For several industries, buyers are potential competitors they may integrate backward. Besides, they have different degrees of bargaining power. Buyers compete with the industry forcing down prices, bargaining for higher quality or more services, and playing competition against each other - all at the expense of industry profitability".

Important determinants of the buyer power, explained by Porter, are the following.

1. The volume of purchase relative to the total sale of the seller.
2. The importance of the product to the buyer in terms of the total cost.
3. The extent of standardization or differentiation of the product.
4. Switching costs.
5. Profitability of the buyer (low profitability tends to pressure costs down).
6. Potential for backward integration by buyer.
7. Importance of the industry's' product with respect to the quality of the buyer's product or services.
8. Extent of buyer's information.

Bargaining Power of Suppliers

The important determinants of supplier power are the following:

1. Extent of concentration and domination in the supplier industry
2. Importance of the product to the buyer.
3. Importance of the buyer to the supplier
4. Extent of substitutability of the product
5. Switching costs.
6. Extent of differentiation or standardization of the product.
7. Potential for forward integration by suppliers.

Porter's analysis, thus, shows that competition in an industry goes well beyond the established players. "Knowledge of these underlying sources of competitive pressure highlights the critical strengths and weaknesses of the company, animates its positioning in its industry, clarifies the areas where strategic changes may yield the greatest payoff, and highlights the areas where industry trends promise to hold the greatest significance as either opportunities or threats. Understanding these sources will also prove to be useful in considering areas for diversification, though the primary focus here is on strategy in individual industries. Structural analysis is the fundamental underpinning for formulating competitive strategy.

1.5 COMPETITOR ANALYSIS

Competitor analysis is necessary for formulating right strategies and positioning for the firm in the industry.

Competitor analysis seeks to find answers to certain basic questions such as:

1. Who are the competitors of the firm?
2. What are the current strategies of the competitors?

3. What are their future goals and likely strategies?
4. What drives the competitor?
5. Where is the competitor vulnerable?
6. How are the competitors likely to respond to the strategies of others?

Porter has suggested a framework for competitor analysis, consisting of four diagnostic components, *viz.*, future goals, **current strategy, assumptions and capabilities**.

As Porter observes, its goals, assumptions, and current strategy will influence the *likelihood, timing, nature, and intensity* of competitor's reactions. Its strengths and weaknesses will determine its *ability* to initiate or react to strategic moves and to deal with environmental or industry events that occur

1.5.1 Competitor Response Profile

An analysis of these components will help to formulate what Porter calls competitor's response profile, *i.e.*, answers to critical questions such as: What moves or developments will provoke the competitor and how is the competitor likely to respond or retaliate?

The competitor response profile seeks to predict the competitor's offensive moves and defensive capabilities.

1.5.2 Future Goals

Analysis of future goals would be helpful to identify the attitude and behavior of the competitor and likely strategies. As Porter observes, a knowledge of goals will allow predictions about whether or not each competitor is satisfied with its present position and financial results and, thereby, how likely that competitor is to change strategy and the vigour with which it will react to outside events or to moves by other firms?

Knowledge of competitor's goals may help to predict its reactions to strategic changes.

Goals of both the business unit and corporate parent need to be examined.

1.5.3 Assumptions

It is critical to understand:

1. The competitor's assumptions about itself.
2. The competitor's assumptions about the industry and the other companies in it.

A firm may perceive itself as a socially conscious organization, the industry leader, quality conscious firm, highly ethical etc. Such assumptions will, obviously, guide the way the firm behaves, including reactions to competitors' moves.

A firm would also have assumptions about the industry and competitors like the industry prospects; competitors' goals, capabilities and weaknesses competitors' possible behaviors and reactions etc.

The strategies and moves of a firm will be influenced by the above two assumptions. The assumptions may or may not be correct.

1.5.4 Current Strategy

Identification of the current strategies of the competitors is a very important component of competitor analysis. A competitor's strategy is most usefully thought of as its key operating policies in each functional area of the business and how it seeks to interrelate the functions.

1.5.5 Capabilities

The ability of a firm to accomplish its goals and to respond to competitor's moves depends on its strengths and weaknesses. Analysis of the strengths and weaknesses of the competitors is, therefore, very important.

1.6 ENVIRONMENT – BUSINESS RELATIONS

Business is the product of the technological, political-legal, economic, social – cultural, global and natural factors amidst which it functions. Three features are common to this web of relationship between business and its environment.

- There is symbolic relationship between business and its environment and among the environmental factors. In other words, business is influenced by its environment and in turn, to certain degree, it will influence the external forces. Similarly, political-legal environment influences economic environment and vice versa. The same relationship between other environment factors too.
- These environmental forces are dynamic. They keep on changing as years roll by, so does business.
- The third feature is that a particular business firm, by itself, may not be in a position to change its environment. But along with other firms, business will be in a position to mould the environment in its favor.

1.7 ENVIRONMENTAL ANALYSIS PROCESS

Environmental analysis is the study of the organizational environment to pinpoint environmental factors that can significantly influence organizational operations

The analysis consists of four sequential steps:

Scanning

It involves general surveillance of all environmental factors and their interactions in order to:

- Identify early signals of possible environmental change
- Detect environmental change already underway

Monitoring

It involves tracking the environmental trends, sequences of events, or streams of activities. It frequently involves following signals or indicators unearthed during environmental scanning.

Forecasting

Strategic decision-making requires a future orientation. Naturally, forecasting is an essential element in environmental analysis. Forecasting is concerned with developing plausible projections of the direction, scope, and intensity of environmental change.

Assessment

In assessment, the frame of reference moves from understanding the environment- the focus of scanning, monitoring and forecasting – to identify what the understanding means for the organization. Assessment, tries to answer questions such as what are the key issues presented by the environment, and what are the implications of such issues for the organization.

1.8 IMPORTANCE OF ENVIRONMENTAL ANALYSIS

The benefits of environmental analysis are as follows;

1. The very idea of environmental analysis makes one aware of the environmental – organization linkage.
2. Development of broad strategies and long-term policies of the firm.
3. Development of action plans to deal with technological advancements.
4. To foresee the impact of socio-economic changes at the national and international levels on the firm's stability.
5. Analysis of competitor's strategies and formulation of effective countermeasures.
6. To keep oneself dynamic.

1.9 REVIEW QUESTIONS

1. In what senses could a college or university is described as a business organization? How would you characterize its 'inputs' and 'outputs'?
2. Describe the various components of external environment that influence the business policy of an organization.
3. What are the components of Business Environment?
4. Briefly explain the need for the study of Business Environment?
5. What is business? How does business of today differ from that of earlier?

ECONOMIC SYSTEMS AND POLITICAL ENVIRONMENT

Structure

2.1 Economic System

2.2 Kinds of Economic System

2.3 The 'Flows' of Economic Activity

2.4 Basic Problems of an Economy and the Role of Government

2.5 Political System

2.6 Functions of State

2.6.1 Classification of Functions of State

2.7 Politics-Economic Synthesis

2.8 Review Questions

2.1 ECONOMIC SYSTEM

Economic system is a social organism through which people make their living. It is constituted of all those individuals, households, farms, firms, factories, banks and government, which act and interact to produce and consume goods and services.

The Concept of Economic Scarcity

Like 'politics', the term '**economic**' tends to be used in a variety of ways and contexts to describe certain aspects of human behavior, ranging from activities such as producing, distributing and consuming, to the idea of frugality in the use of a resource (e.g. being 'economical' with the truth). Modern definitions stress how such behavior, and the institutions in which it takes place (e.g. households, firms, governments, banks), are concerned with the satisfaction of human needs and wants through the transformation of resources into goods and services which are consumed by society. These processes are said to take place under conditions of '**economic scarcity**'.

The economist's idea of 'scarcity' centers on the relationship between a society's needs and wants and the resources available to satisfy them. In essence, economists argue that whereas needs and wants tend to be unlimited, the resources which can be used to meet those needs and wants are finite and accordingly no society at any time has the capacity

to provide for all its actual or potential requirements. The assumption here is that both individual and collective needs and wants consistently outstrip the means available to satisfy them, as exemplified, for instance, by the inability of governments to provide instant health care, the best roads, education, defence, railways, and so on, at a time and place and of a quality convenient to the user. This being the case, ‘choices’ have to be made by both individuals and society concerning priorities in the use of resources, and every choice inevitably involves a ‘sacrifice’ (i.e. forgoing an alternative).

Economists describe this sacrifice as the ‘**opportunity cost**’ or ‘**real cost**’ of the decision that is taken (e.g. every pound spent on the health service is a pound not spent on some other public service) and it is one which is faced by individuals, organizations (including firms), governments and society alike.

From a societal point of view the existence of economic scarcity poses three serious problems concerning the use of resources:

- 1 What to use the available resources for? That is, what goods and services should be produced (or not produced) with the resources (sometimes described as the ‘guns v. butter’ argument)?
- 2 How best to use those resources? For example, in what combinations, using what techniques and what methods?
- 3 How best to distribute the goods and services produced with them? That is, who gets what, how much and on what basis?

In practice, of course, these problems tend to be solved in a variety of ways, including barter (voluntary, bilateral exchange), price signals and the market, queuing and rationing, government instruction and corruption (e.g. resources allocated in exchange for personal favors), and examples of each of these solutions can be found in most, if not all, societies, at all times. Normally, however, one or other main approach to resource allocation tends to predominate and this allows analytical distinctions to be made between different types of economic system. One important distinction is between those economies which are centrally planned and those which operate predominantly through market forces, with prices forming the integrating mechanism. Understanding this distinction is fundamental to an examination of the way in which business is conducted and represents the foundation on which much of the subsequent analysis is built.

The Centrally Planned Economy

In this type of economic system – associated with the post-Second World War socialist economies of Eastern Europe, China, Cuba and elsewhere – most of the key decisions on production are taken by a central planning authority, normally the state and its agencies. Under this arrangement, the state typically:

- owns and/or controls the main economic resources;
- establishes priorities in the use of those resources;
- sets output targets for businesses which are largely under state ownership and/or control;
- directs resources in an effort to achieve these predetermined targets; and
- seeks to co-ordinate production in such a way as to ensure consistency between output and input demands.

The fact that an economy is centrally planned does not necessarily imply that all economic decisions are taken at central level; in many cases decision making may be devolved to subordinate agencies, including local committees and enterprises. Ultimately, however, these agencies are responsible to the centre and it is the latter which retains overall control of the economy and directs the use of scarce productive resources. The problem of co-coordinating inputs and output in a modern planned economy is, of course, a daunting task and one which invariably involves an array of state planners and a central plan or blueprint normally covering a number of years (e.g. a five-year plan). Under such a plan, the state planners would establish annual output targets for each sector of the economy and for each enterprise within the sector and would identify the inputs of materials, labor and capital needed to achieve the set targets and would allocate resources accordingly. Given that the outputs of some industries (e.g. agricultural machinery) are the inputs of others (e.g. collective farms), it is not difficult to see how the overall effectiveness of the plan would depend in part on a high degree of co-operation and co-ordination between sectors and enterprises, as well as on good judgment, good decisions and a considerable element of good luck. The available evidence from planned economies suggests that none of these can be taken for granted and each is often in short supply.

2.2 KINDS OF ECONOMIC SYSTEMS

Free Enterprise Economy

This economic system works on the principle of Laissez Faire system, i.e., the least interference by the government or any external force. The primary role of the government, if any, is to ensure free working of the economy by removing obstacles to free competition.

A free Enterprise Economy is characterized as follows:

- Means of production are privately owned by the people who acquire and possess them;
- Private gains are the main motivating and guiding force for carrying out economic activities;
- Both consumers and firms enjoy the freedom of choice; consumers have the freedom to consume what they want to and firms have the choice to produce what they want to;

- The factor owners enjoy the freedom of occupational choice, i.e., they are free to use their resources in any legal business or occupation;
- There exists a high degree of competition in both commodity and factor markets; and
- There is least interference by the government in the economic activities of the people; the government is in fact supposed to limit its traditional functions viz, to defence, police, justice, some financial organizations and public utility services.

Government Controlled Economy

The government-controlled economies are also called as Command, Centrally planned or Socialist economies. Such economies are, in contradistinction to the free enterprise economies, controlled, regulated and managed by the government agencies.

The other features of a pure socialist economy are:

- Means of production are owned by the society or by the state in the name of the community – private ownership of factors and property is abolished;
- Social welfare is the guiding factor for economic activities – private gains, motivations and initiatives are absent,
- Freedom of choice for the consumers is curbed to what society can afford for all; and
- The role of market forces and competition is eliminated by law.

Mixed Economy

A mixed economy is one in which there exist both government and private economic systems. It is supposed to combine good elements of both free enterprise and socialist economies. A mixed economy is widely known as one, which had both “**public sector**” (the government economy) and “**private sector**” (the private economy). The private sector has features of a free enterprise economy and the public sector has features of socialist economy. It is important to note here that most economies in the world today are

There are two different forms of the Mixed Economies.

- **Mixed Capitalist Economies**

A mixed Capitalist economy is a variant of the free enterprise economic system. To this category fall the highly developed nations like the United States, U.K., France, Japan etc. though these economies have a very large government sector, their private sectors work on the principles of the free enterprise system. The government plays a significant role in preserving capitalist mode of production, ensuring a workable competition in factor and product markets, providing infrastructure for promotion of private sector economic activities.

- **Mixed Socialist Economies**

To the category of the Mixed Socialist Economies belong the countries which have adopted “socialist pattern of society: and economic planning as the means of growth and

social justice (e.g. India) and the former communist countries (eg. Russia and china) which have of late carried out drastic economic reforms and liberalized their economies for private entrepreneurship. The government of these countries takes upon themselves to control and regulate the private sector activities in accordance with the plan objectives.

2.3 THE 'FLOWS' OF ECONOMIC ACTIVITY

Economic activity can be portrayed as a flow of economic resources into firms (i.e. productive organizations), which are used to produce output for consumption, and a corresponding flow of payments from firms to the providers of those resources, who use them primarily to purchase the goods and services produced. These flows of resources, production, income and expenditure accordingly represent the fundamental activities of an economy at work. Figure 2.1 illustrates the flow of resources and of goods and services in the economy – what economists describe as '**real flows**'.

In effect, firms use economic resources to produce goods and services, which are consumed by private individuals (private domestic consumption) or government (government consumption) or by overseas purchasers (foreign consumption) or by other firms (capital formation). This consumption gives rise to a flow of expenditures that represents an income for firms, which they use to purchase further resources in order to produce further output for consumption. This flow of income and expenditures is shown in Figure 2.2.

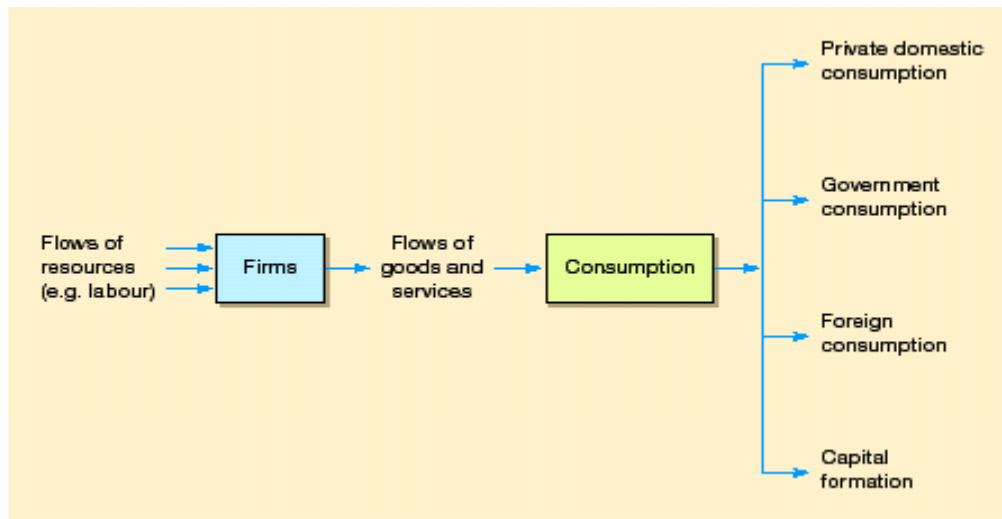


Figure 2.1 'Real Flows' in the Economy

The interrelationship between **income flows** and real flows can be seen by combining the two diagrams into one, which for the sake of simplification assumes only two groups, operate in the economy: firms as producers and users of resources, and private individuals as consumers and providers of those resources (see Figure 2.3).

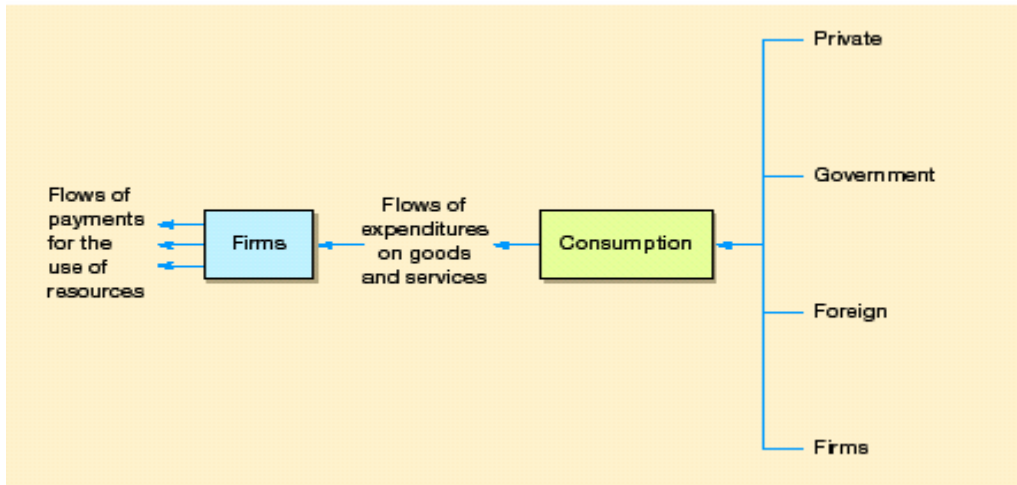


Figure 2.2 Income Flows in the Economy

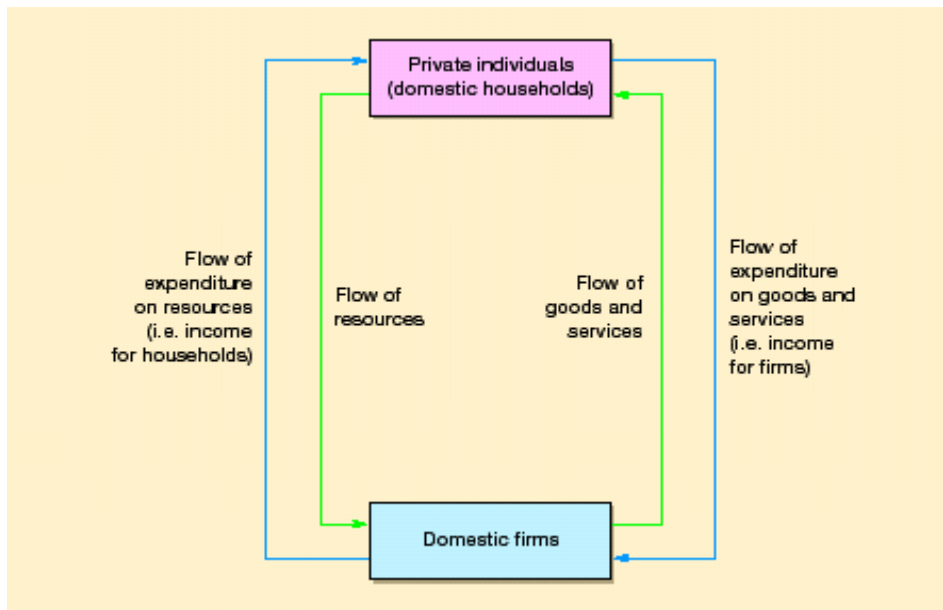


Figure 2.3 A Simplified Model of Real Flows and Income Flows

Real flows are shown by the arrows moving in an anti-clockwise direction; income flows by the arrows flowing in a clockwise direction. Despite a degree of over-simplification, the model of the economy illustrated in Figure 2.3 is a useful analytical tool which highlights some vitally important aspects of economic activity which are of direct relevance to the study of business.

The model shows, for example, that:

1. Income flows around the economy, passing from households to firms and back to households and on to firms, and so on, and these income flows have corresponding real flows of resources, goods and services.
2. What constitutes an income to one group (e.g. firms) represents an expenditure to another (e.g. households), indicating that income generation in the economy is related to spending on consumption of goods and services and on resources (e.g. the use of labor).
3. The output of firms must be related to expenditure by households on goods and services, which in turn is related to the income the latter receive from supplying resources.
4. The use of resources (including the number of jobs created in the economy) must also be related to expenditure by households on consumption, given that resources are used to produce output for sale to households.
5. Levels of income, output, expenditure and employment in the economy are, in effect, interrelated.

From the point of view of firms, it is clear from the model that their fortunes are intimately connected with the spending decisions of households and any changes in the level of spending can have repercussions for business activity at the micro as well as the macro level. In the late 1980s, for instance, the British economy went into recession, largely as a result of a reduction in the level of consumption that was brought about by a combination of high interest rates, a growing burden of debt from previous bouts of consumer spending, and a decline in demand from some overseas markets also suffering from recession. While many businesses managed to survive the recession, either by drawing from their reserves or slimming down their operations, large numbers of firms went out of business, as orders fell and costs began to exceed revenue. As a result, output in the economy fell, unemployment grew, investment by firms declined, and house prices fell to a point where some house owners owed more on their mortgage than the value of their property (known as 'negative equity'). The combined effect of these outcomes was to further depress demand, as individuals became either unwilling or unable to increase spending and as firms continued to shed labor and to hold back on investment. By late 1992, few real signs of growth in the economy could be detected, unemployment stood at almost 3 million, and business confidence remained persistently low.

The gradual recovery of the British economy from mid-1993 – brought about by a return in consumer confidence in the wake of a cut in interest rates – further emphasizes the key link between consumption and entrepreneurial activity highlighted in the model. Equally, it shows, as did the discussion on the recession, that a variety of factors can affect spending (e.g. government policy on interest rates) and that spending by households is only one type of consumption in the real economy.

In order to gain a clearer view of how the economy works and why changes occur over time, it is necessary to refine the basic model by incorporating a number of other key variables influencing economic activity. These variables – which include savings, investment spending, government spending, taxation and overseas trade.

2.4 BASIC PROBLEMS OF AN ECONOMY AND THE ROLE OF GOVERNMENT

Whatever the nature of the economic system, all types of economies have been faced with certain common basic problems. The major economic problems faced by an economy may be classified into two broad groups: (i) **micro-economic problems** called *basic problems*, which are related to the working of the constituents of the economic system; and (ii) **macro-economic problems** related to the growth, stability, and management of the economy as a whole. The way the basic problems of an economy are solved depends on the nature of the economy. While in a socialist economy they are solved by the government agencies, like central planning authority, in a free enterprise or mixed capitalist economy this task is performed by the Price Mechanism or Market Mechanism. Though free enterprise system is capable of bringing economic growth, it does not ensure a stable, sustained, and balanced growth. It becomes therefore inevitable for the government to intervene fair competition, and help the economy in achieving its goals – efficiency, stability, growth and economic justice.

Now, the question arises as to what should be the appropriate role of the government in economic management of the country or what should be the form, nature and extent of government's interference with market mechanism. Nevertheless, the economic role of the government can be broadly categorized on the basis of the three economic systems which presently prevail in the world, viz., Capitalist System or Free Enterprise System, Socialist System, and the Mixed-Economy System.

Capital Society: In this system, the primary role of the government are: (i) to preserve and promote free market mechanism wherever it is possible to ensure a workable competition, (ii) to remove all unnecessary restrictions on the free operation of competitive market, and (iii) to provide playground and rules of the market game through necessary interventions and controls so that free competition can work effectively. It may be inferred that the government's role in a capitalist society is supposed to be limited to (a) restoration and promotion of necessary conditions for efficient working of free market mechanism; and (b) to enter those areas of production and distribution in which private entrepreneurship is lacking or is inefficient.

Socialist Economy: In contrast with the capitalist system, the role of government in a Socialist economy is much more exhaustive. While in the former, the government is supposed to play a limited role in the economic sphere, in the latter, it exercises comprehensive control on almost all economic activities. In the socialist system, not only there is a complete disregard for free enterprise and market mechanism but also these systems are abolished by law. The private ownership of factors of production is replaced by the State ownership. All economic activities are centrally planned, controlled and

regulated by the State. All decisions regarding production resources, allocation, employment, pricing etc., are centralized in the hands of government or the Central Planning Authority.

Mixed Economy: In this system, a major part of the economy, the **private sector**, is allowed to function on the principles of free enterprise system or free market mechanism within a broad political and economic policy framework. The other part of the economy, the **public sector**, is organized and managed along the socialist pattern. The public sector is created by reserving certain industries, trade, services, and activities for the government control and management. The government prevents by an ordinance the entry of private capital into the industries reserved for the public sector. Another way of creating or expanding the public sector is **nationalization** of existing industries. The promotion, control and management of the public sector industries is the sole responsibility of the State. Apart from controlling and managing the public sector industries the government controls and regulates the private sector through its industrial, monetary and fiscal policies. If necessary, direct controls are also imposed.

2.5 POLITICAL SYSTEMS

The Nature of Political Activity

All social situations at certain times require decisions to be made between alternative courses of action. Parents may disagree with their offspring about the kind of clothes they wear or how late they stay out at night or how long they grow their hair. Students may challenge lecturers about a particular perspective on an issue or when they should submit a piece of work. The members of the board of directors of a company may have different views about future investment or diversification or the location of a new factory. In all these cases, some solution needs to be found, even if the eventual decision is to do nothing. It is the processes involved in arriving at a solution to a problem, where a conflict of opinion occurs, that are the very essence of political activity.

Politics, in short, is concerned with those processes which help to determine how conflicts are contained, modified, postponed or settled, and as such can be seen as a universal social activity. Hence, individuals often talk of ‘office politics’ or the ‘politics of the board room’ or the ‘mediating role’ played by a parent in the event of a family dispute. For most individuals, however, the term ‘politics’ tends to be associated with activities at state level, where the resolution of conflict often involves large numbers of people and may even involve individuals in other states. Political activity at this level is clearly qualitatively different from the other social situations mentioned, and given the scale and complexity of the modern state; the problems requiring solutions can often be acute and chronic. Solving those problems tends to be seen, at least in part, as the function of government.

Government as a process is concerned with the pursuit and exercise of power – the power to make decisions which affect the lives of substantial numbers of people, be it at local, regional, national or even international level. Government may also refer to the

institutions through which power tends to be formally and legitimately exercised, whether they are cabinets, parliaments, councils, committees or congresses. Whereas the pursuit and exercise of power tends to be an enduring feature of any society, governments are normally transitory, comprising those individuals and/or groups who, at a particular time, have the responsibility for controlling the state, including making laws for 'the good of society'. How governments exercise their power and the ideological foundations, on which this is based, helps to indicate the nature of the political system and its likely approaches to the resolution of conflicts.

2.6 FUNCTIONS OF STATE

The State is the centre of Public Finance. The State requires money and services for the performance of its functions. The first question is what the nature of the State is, and what are its functions? To answer this we shall have to borrow a little from Political Science. The best recent authorities on Political Science seem to answer the question, "What is the State ? " with a more or less expanded but not essentially modified restatement of Aristotle's famous dictum : " It is manifest that the State is one of the things that exist by nature, and that man is by nature a political animal." The State is an organism into which the individual is born, and through which alone he can hope to reach his highest development. Upon its existence, and the perfection with which it performs its functions, depends the degree of social organization possible. The State seems to be God-given to enable society to organize on a grand scale for the accomplishment of practical ends far beyond the reach of the individual, — ends upon which the welfare of the individual depends.

If Political Science cannot in the nature of things give us any definite, theoretical limits to the expansion or the contraction of State functions, can such limits be found in Public Finance? If the common statement that "the State regulates its income by its expenditure and not its expenditure by its income" is altogether true, there can be no limit set by Public Finance to the possible expansion of State functions. But there are as a matter of fact many important exceptions recognized. Those exceptions are: (1) that statesmen in deciding as to the advisability of any new expenditure necessarily consider the amount of burden it will impose on the tax-payers. The expansion of municipal activities in the last twenty-five years has been so rapid that at present any further expansion is, in many instances, at least temporarily checked by the difficulties in the way of meeting the cost. (2) There are some instances where for political reasons income has outrun what was regarded as wise expenditure and new ways of spending have had to be devised. This is a decidedly more unfortunate state of affairs than the other, for such forced expenditure seldom takes a wise direction. Witness the wholesale plundering of the United States treasury for pensions. (3) Expenditures may sometimes rise very rapidly, and necessarily so, at a time when it would be extremely unwise to attempt to increase the revenues. At such times the practice of nations, — a practice that has proven itself wise, — has been to let expenditure run beyond the income and borrow the difference.

(4) One of the prime requisites of a good system of public revenues is that the sums taken from the people each year in the various ways shall be as steady as possible. The reason

for this will be made clear under the general consideration of revenue. That fact, however, forbids our determining the annual revenues absolutely by the annual expenditures. The general practice of nations is to increase expenditure, when it is absolutely necessary, (5) if not absolutely necessary, when it offers advantages which more than compensate for the increased burden on the revenues. The experience of nations has also shown that it is universally better to do the public business, if expenses are increasing rapidly, on a deficit rather than on a surplus. If expenses are for a considerable period quite uniform, the usual policy is to keep the revenues, as nearly as possible, equal to them, but not in excess of them, and when expenses can for some reason be lessened, some of the revenues may be applied to the amortization of accumulated deficits. It would seem, then, that steadiness of revenue is treated as the more important consideration. Herein lays a limit, but not an absolutely fixed one, to the expansion of expenditure and of State functions.

2.6.1 Classification of Functions of State

Functions of the state vary from basic minimum requirements to active participation in several other sectors. Fig 2.4 classifies the functions of government along a continuum, from activities that will not be taken at all without state intervention to activities in which the state plays an active role in coordinating markets or redistributing assets.

- The basic functions include the pure public goods such as the provision of property rights, macroeconomic stability, and control of infectious disease, safe water, roads, and protection of the destitute. In many countries the state is not even providing these. Recent reforms have emphasized economic fundamentals. But social and institutional. (Including legal) fundamentals are equally important to avoid social disruption and ensure sustained development.
- Going beyond these basic services are the intermediate functions, such as management of externalities (pollution, for example), regulation of monopolies, and the provision of social insurance (pensions, unemployment benefits). Here, too, the government cannot choose whether, but only how best to intervene, and government can work in partnership with markets and civil society to ensure that these public goods are provided.
- States with strong capability can take more activist functions, dealing with the problem of missing markets by helping coordination.

Reinvigorating the State's Capability

Renovating the state's capability can be achieved through the following

- **Rules and Restraints:** Mechanism for enforcing the rule of law such as an independent judiciary, are critical foundations for sustainable development. Along with appropriate separation of powers and the presence of watchdog bodies, they also restrain arbitrary behavior.

	Addressing market failure				Improving equity
Minimal Functions	Providing pure public goods				Protecting the poor
	Defense				Antipoverty programs
	Law and Order				Disaster relief
	Property Rights				
	Macroeconomic management				
	Public Health				
Intermediate Functions	Addressing externalities:	Regulating monopoly:	Overcoming imperfect information:	Providing social insurance	Providing social insurance:
	education	utility regulation	Insurance		Redistributive pensions
	environmental protection	anti-trust	Financial regulation		Family allowances
			Consumer protection		Unemployment insurance
Activist Functions	Coordinating private activity:				Redistribution:
	Fostering markets				Asset redistribution
	Cluster initiatives				

Figure 2.4 Functions of the State

- **Competitive Pressure:** Competitive pressure can come from within the state bureaucracy, through recruitment of civil servants on the basis of merit. It can come from the domestic private sector, through contracting out for services and allowing private providers to compete directly with public agencies. Or it can come from the international market place, through the trade and through the influence of global bond markets on fiscal decisions.
- **Voice and Partnership:** The means to achieve transparency and openness in modern society are many and varied- business councils, interaction groups, and consumer groups, to name a few. Institutional working arrangement with community groups can contribute to greater state effectiveness by giving citizens a greater voice in the formulation of government's policies. And partnership between levels of government and with international bodies can help in the provision of local and global public goods.

2.7 POLITICO-ECONOMIC SYNTHESIS

The economic problem of resource allocation clearly has a political dimension, given its focus on the ownership, control and use of wealth-producing assets within society. This

allows links to be made between a country's chosen economic system and its political regime. A useful way of representing possible relationships is illustrated in Figure 2.5. Political systems can be characterized as ranging from democratic to authoritarian, depending on the degree of public involvement in decision-making processes. Similarly, economic systems can be seen to range from free market to planned, according to the level of state intervention in the process of resource allocation. This two-dimensional model thus provides for four major combinations of politico economic systems, ranging from democratic–free-market on the one hand (quadrant 1) to authoritarian–planned on the other (quadrant 3).

In applying this model to specific cases, it is clear that free-market approaches to resource allocation are predominantly associated with democratic states. Such a link is not surprising. Democracy, after all, includes the notion of individuals being able to express their preferences through the ballot box and having the opportunity to replace one government with another at periodic intervals. In free markets similar processes are at work, with individuals effectively 'voting' for goods and services through the price system and their expressed preferences being reflected in the pattern of resource allocation.

A link between authoritarian regimes and planned economic systems can equally be rationalized, in that government control over the political system is considerably facilitated if it also directs the economy through the ownership and/or control of the means of production, distribution and exchange. In effect, the relative absence of democratic mechanisms, such as free elections and choice between alternative forms of government, is echoed in the economic sphere by the inability of individuals to exercise any real influence over resource allocation. At the extreme, this could involve a government ban on any forms of free enterprise and total government control of the pattern of output and consumption in an economy which is devoid of effective consumer sovereignty.

In practice, of course, the picture is much more complicated than suggested by this simple dichotomy. Some authoritarian states, for instance, have predominantly capitalist economic systems (quadrant 4), while some democratic countries have a substantial degree of government intervention (i.e. moving them towards quadrant 2), either by choice or from necessity (e.g. wartime). Added to this, even in states where the political or economic system appears to be the same, considerable differences can occur at an operational and/or institutional level and this gives each country a degree of uniqueness not adequately portrayed by the model. That said, it is still the case that the basic congruity between democracy and free-market systems represents a powerful and pervasive influence in the business environment of the world's principal democratic states. The process of economic reform – as in Eastern Europe – accordingly tends to be accompanied by corresponding pressures for political change and these are often resisted by regimes not prepared to give up their political and economic powers and their elite status.

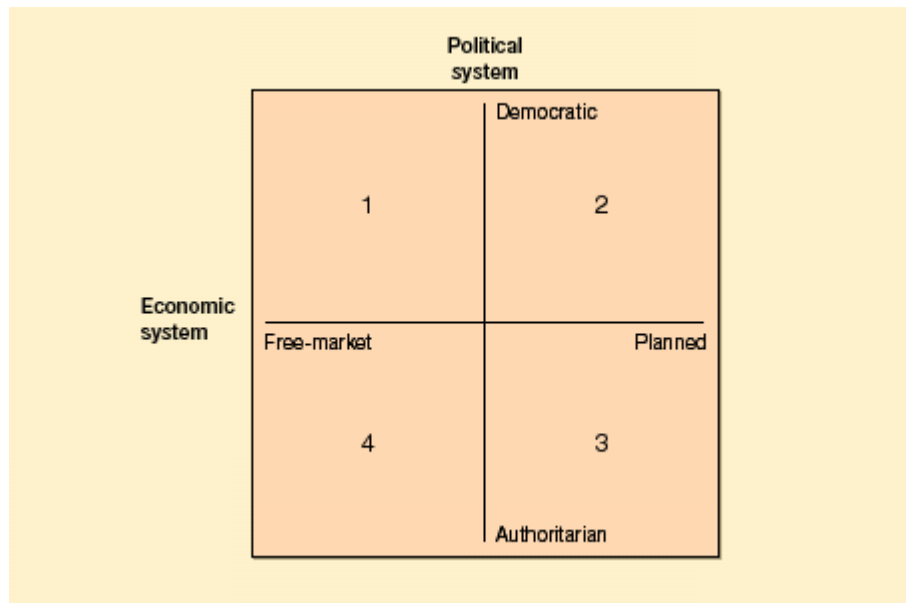


Figure 2.5 Politico-Economic Systems

2.8 REVIEW QUESTIONS

1. Analyze the four fold role of the government in business. Also explain in what respects the role of government has been redefined in India.
2. Narrate the influence of economic factors on business.
3. Explain briefly Functions of State.
4. Bring out the main Economic and Political environmental factors that affect the modern business organizations.
5. What is an economic system? What are the basic problems of an economic system?
6. “The fundamental economic problem of an economy is the problem of choice”. Discuss.
7. Explain the role of government in solving problems arised out of different economic systems.
8. What are the features of a mixed economic system?

ECONOMIC TRANSITION IN INDIA: PRIVATISATION AND GLOBALISATION

Structure

3.1 Introduction

3.2 Privatization

3.2.1 Objects

3.2.2 Privatization Routes

3.2.3 Benefits

3.2.4 Criticisms

3.2.5 Conditions for Success

3.3 Privatization in India

3.4 Privatization Policy

3.5 Types of Privatization

3.6 Drawbacks of Privatization

3.7 Globalization

3.8 Reasons for Globalization

3.9 Features of Globalization

3.10 Stages of Globalization

3.10.1 Globalization Strategies

3.11 Benefits

3.12 Drawbacks of Globalization

3.13 Essentials of Globalization

3.14 Globalization Impact on Indian Economy

3.15 Review Questions

3.1 INTRODUCTION

Indian economy had experienced major policy changes in early 1990s. The new economic reform, popularly known as, **Liberalization, Privatization and Globalization** (LPG model) aimed at making the Indian economy as fastest growing economy and globally competitive. The series of reforms undertaken with respect to industrial sector, trade as well as financial sector aimed at making the economy more efficient. With the onset of reforms to liberalize the Indian economy in July of 1991, a new chapter has dawned for India and her billion plus population. This period of economic transition has had a tremendous impact on the overall economic development of almost all major

sectors of the economy, and its effects over the last decade can hardly be overlooked. Besides, it also marks the advent of the real integration of the Indian economy into the global economy.

This era of reforms has also ushered in a remarkable change in the Indian mindset, as it deviates from the traditional values held since Independence in 1947, such as self reliance and socialistic policies of economic development, which mainly due to the inward looking restrictive form of governance, resulted in the isolation, overall backwardness and inefficiency of the economy, amongst a host of other problems. This, despite the fact that India has always had the potential to be on the fast track to prosperity.

Now that India is in the process of restructuring her economy, with aspirations of elevating herself from her present desolate position in the world, the need to speed up her economic development is even more imperative. And having witnessed the positive role that Foreign Direct Investment (FDI) has played in the rapid economic growth of most of the Southeast Asian countries and most notably China, India has embarked on an ambitious plan to emulate the successes of her neighbors to the east and is trying to sell herself as a safe and profitable destination for FDI.

Globalization has many meanings depending on the context and on the person who is talking about. Though the precise definition of globalization is still unavailable a few definitions are worth viewing, Guy Brainbant: says that the process of globalization not only includes opening up of world trade, development of advanced means of communication, internationalization of financial markets, growing importance of MNCs, population migrations and more generally increased mobility of persons, goods, capital, data and ideas but also infections, diseases and pollution. The term globalization refers to the integration of economies of the world through uninhibited trade and financial flows, as also through mutual exchange of technology and knowledge. Ideally, it also contains free inter-country movement of labor. In context to India, this implies opening up the economy to foreign direct investment by providing facilities to foreign companies to invest in different fields of economic activity in India, removing constraints and obstacles to the entry of MNCs in India, allowing Indian companies to enter into foreign collaborations and also encouraging them to set up joint ventures abroad; carrying out massive import liberalization programs by switching over from quantitative restrictions to tariffs and import duties, therefore globalization has been identified with the policy reforms of 1991 in India.

3.2 PRIVATISATION

Privatization, which has become a universal trend, means transfer of ownership and/or management of an enterprise from the public sector to the private sector. It also means the withdrawal of the state from an industry or sector, partially or fully. Another dimension of privatization is opening up of an industry that has been reserved for the public sector to the private sector. Privatization is an inevitable historical reaction to the indiscriminate expansion of the state sector and the associated problems. Even in the 'communist' countries it became a vital measure of economic rejuvenation.

Definitions:

1. Privatization may be defined as the transfer of the public sector activities and functions to the private sector.
2. This applies to the commercial and industrial enterprises which are often owned, managed and implemented by the public sector which could otherwise be operated by the private sector.
3. Privatization is premised on the assumption of the superiority of market forces over administrative directives in governing economic activity to achieve efficiency.

3.2.1 Objects

The objects are:

- To improve the performance of PSUs (Public Sector Undertakings) so as to lessen the financial burden on taxpayers.
- To increase the size and dynamism of the private sector, distributing ownership more widely in the population at large.
- To encourage and to facilitate private sector investments, from both domestic and foreign sources.
- To generate revenues for the state.
- To reduce the administrative burden on the state.
- Launching and sustaining the transformation of the economy from a command to a market model.

3.2.2 Privatization Routes

The important ways of privatization are:

- Divestiture or privatization of ownership, through the sales of equity.
- Denationalization or reprivatization.
- Contracting - under which government contracts out services to other organizations that produce and deliver them.
- Franchising- authorizing the delivery of certain services in designated geographical areas- is common in utilities and urban transport.
- Government withdrawing from the provision of certain goods and services leaving them wholly or partly to the private sector.
- Privatization of management, using leases and management contracts
- Liquidation, which can be either formal or informal. Formal liquidation involves the closure of an enterprise and the sale of its assets. Under informal liquidation, a firm retains its legal status even though some or all of its operations may be suspended.

3.2.3 Benefits

The benefits of privatization may be listed down as follows:

- It reduces the fiscal burden of the state by relieving it of the losses of the SOEs (State owned Enterprise) and reducing the size of the bureaucracy.

- Privatization of SOEs enables the government to mop up funds.
- Privatization helps the state to trim the size of the administrative machinery.
- It enables the government to concentrate more on the essential state functions.
- Privatization helps accelerate the pace of economic developments as it attracts more resources from the private sector for development.
- It may result in better management of the enterprises.
- Privatization may also encourage entrepreneurship.
- Privatization may increase the number of workers and common man who are shareholders. This could make the enterprises subject to more public vigilance.

3.2.4 Criticisms

Some of the important argument against privatization is as follows:

- The public sector has been developed with certain noble objectives and privatization means discarding them in one stroke.
- Privatization will encourage concentration of economic power to the common detriment.
- If privatization results in the substitution of the monopoly power of the public enterprises by the monopoly power of private enterprises it will be very dangerous.
- Privatization many a time results in the acquisition of national firms by foreign firms.
- Privatization of profitable enterprises, including potentially profitable, means foregoing future streams of income for the government.
- Privatization of strategic and vital sectors is against national interests.
- There are well managed and ill-managed firms both in the public and private sectors. It is not sector that matters, but the quality and commitment of the management.
- The capital markets of developing countries are not developed enough for efficiently carrying out privatization.
- Privatization in many instances is a half-hearted measure and therefore it is not properly carried out. As a result that the expected results may not be achieved.
- In many instance, there are vested interested behind privatization and it amounts deceiving the nation. In many countries privatization often has been a “garage sale” to favored individuals and groups.

3.2.5 Conditions for Success

- Privatization cannot be sustained unless the political leadership is committed to it, and unless it reflects a shift in the preferences of the public arising out of dissatisfaction with the performance of other alternatives.
- Replacement of a government monopoly by a private monopoly may not increase public welfare-there must a multiplicity of private suppliers. Freedom of entry to provide goods and services.

- Public services to be provided by the private sector must be specific or have measurable outcome.
- Lack of specificity makes it more difficult to control services provided by the private sector. Service delivery by non-governmental organizational or local governments may be more appropriate under these conditions.
- Consumers should be able to link the benefits they receive from a service to the costs they pay for it, since they will then shop more wisely for difficult services.
- The importance of educating consumers and disseminating information to the public is necessary.
- Privately provided services should be less susceptible to fraud than government services if they are to be effective.
- Equity is an important consideration in the delivery of public services. Broadly speaking, the benefits of privatization can accrue to the capital owner to the consumer and to public at large.

3.3 PRIVATISATION IN INDIA

In India, although there were some isolated cases of privatization, no definite policy decision was taken until the new economic policy was ushered in. The accumulated losses of many SOEs, including some state transport corporations, are larger than the capital invested in them. Privatization of certain sectors and enterprises are, therefore, necessary to reduce the budgetary burden on the public, to make available more resources for the development activities, to enable the government to concentrate more on the essential and priority areas. The new industrial policy, which has abolished the public sector monopoly in all but a very few industries is a significant step towards Privatization. The new policy also proposes Privatization of enterprises by selling shares to mutual funds, workers and the public. The central government has been reviewing the existing portfolio of public investment with a view to offloading public investment. The disinvestments Commission was set up by Government of India in August 1996, for suggesting the modalities for undertaking disinvestments of equities for select PSUs. The commission has recommended disinvestments at varying levels for a number of PSUs

How important is privatization in India?

The first order issue is that of competition policy. When the government hinders competition by blocking entry or FDI, this is deeply damaging. Once competitive conditions are ensured, there are, indeed, benefits from shifting labor and capital to more efficient hands through privatization, but this is a second order issue.

The difficulties of governments that run businesses are well-known.

- PSUs face little "market discipline". There is neither a fear of bankruptcy, nor are there incentives for efficiency and growth.
- The government is unable to obtain efficiency in utilizing labor and capital; hence the GDP of the country is lowered to the extent that PSUs control labor and capital.
- When an industry has large PSUs, which are able to sell at low prices because capital is free or because losses are reimbursed by periodic bailouts, investment in that entire industry is contaminated. This was the experience of Japan, where the "zombie firms" - loss-making firms that were artificially rescued by the government - contaminated investment in their industries by charging low prices and forcing down the profit rate of the entire industry.
- Further, in many areas, the government faces conflicts of interest between a regulatory function and an ownership function. As an example, the Ministry of Petroleum crafts policies which cater for the needs of government as owner, which often diverge from what is best for India. There is a fundamental loss of credibility when a government regulator faces PSUs in its sector: there is mistrust in the minds of private investors, who demand very high rates of return on equity in return for bearing regulatory risk.

These arguments have led many economists to advocate large-scale privatization, so as to clear the slate, and get on with the task of building a mature market economy. The role model in this regard is Germany. After the collapse of communism and the unification of East and West Germany, an auction was held for selling off all East German PSUs.

Negative bids were permitted; i.e. the government was willing to even pay a private manager to take over a loss-making business if no higher bid was to be found. Through this, Germany was able to erase the heritage of socialism, and get on with the task of running an efficient market economy.

While such a game plan is entirely feasible in India, the present Parliament desires no privatization. Does this mean that in the immediate future, progress in economic policy on privatization must merely wait for the next elections?

When we look at various industries in India, the gains from privatization are quite heterogeneous. In some cases, there are hopelessly loss-making PSUs. These operate in industries where private and foreign firms have been able to come in, and the PSU has been left far behind the standards of quality and price set by the private sector.

The PSUs should ideally have been sold off long ago, but today, these firms are irrelevant for the competitive dynamics of the industries that they operate in. The only issue is that of getting the land, the labor and some machinery out of public hands.

When privatization is achieved, India will benefit because the private buyer will produce more GDP using the same resources, and the flow of budgetary support to these firms will cease. The government should be happy to get these firms out of its hands with negative bids.

The next and most interesting category comprises industries like telecom and airlines. In these areas, India has witnessed the dramatic benefits that come from the entry of private players.

Telecom and airline services in India are now dramatically improved, if not yet up to world-class, by changing rules in a way that permitted limited entry to domestic and foreign players. The privatization of VSNL was critically important because it was part of the opening up of the ILD sector to competition: the government would arguably have been tardier in opening up if it had a vested interest through ownership of VSNL. However, the key innovation, which broke with the stasis of socialism, was opening up entry barriers - not privatization.

In both sectors, the full benefits from permitting foreign competitors, which are only present in much muted fashion, remain to be harnessed. While Spice Jet is a good airline, there are bigger benefits waiting to be obtained by having domestic flights run by Lufthansa and Singapore Airlines. In both sectors, the defining issue in policy is the removal of entry barriers, not privatization.

Looking forward, there is a good chance that in some years, BSNL, MTNL and the merged airline will end up like one of the many defunct PSUs of today. It makes sense for the government to sell today - while the going is good. But the privatization of these three firms is no longer the most important issue - the further elimination of entry barriers faced by domestic and foreign firms is.

What does this tell us about banking? The decline in market shares of PSU banks, while helped along by strikes of PSU bank unions, has proceeded only slowly. This is partly because there is a fundamentally non-level playing field where private and foreign banks have deposit insurance for only Rs. 100,000 of deposits while PSU banks have unlimited deposit insurance. This gives one reason in favour of bank privatization: it is inherently difficult to achieve competitive conditions without privatization.

But equally, there is no industry in India where the License-permit Raj hinders entry more than in the case of banking. At a time when the Indian economy is booming, and every kind of business is being created, the one industry where we see no new firms starting up is banking. This has surely got to do with government restrictions on entry. There is absolutely no industry in India where the opening of branch offices by foreign firms and private firms requires permission from the government. When Ford operates in India, it has to obey rules on FDI, but after that, it never has to go back to the government to take permission to open offices.

What is a worse, all foreign bank - put together - are given permission to open 12 branches per year in the full country. There is no worse instance where contemporary Indian policy-making is animated by ideas from the 1960s.

3.4 PRIVATISATION POLICY

The current direction of Privatization policy is to put national resources and assets to optimal use and in particular to unleash the productive potential inherent in our public sector enterprises. The policy of disinvestments specifically aimed at:

- Modernization and up gradation of Public Sector Enterprises.
- Creation of new assets.
- Generation of Employment.
- Retiring of public debt.
- To ensure that disinvestments does not result in alienation of national assets, which through the process of disinvestments, remain where they are. It will also ensure that disinvestment does not result in private monopolies.
- Setting up a Disinvestments Proceeds Fund.
- Formulating the guidelines for the disinvestments of natural assets companies.

An important part of a privatization plan are policy decisions regarding what type of investors will be sought and how much of the company will be sold to different types of investors. Potential investors can be classified into six categories:

- Employees of the firm
- Strategic industry partner
- Domestic institutional investors
- Foreign institutional investors
- Domestic general public
- Foreign general public

There is different policy considerations associated with each type of investor.

Employees of the firm

Winning the acquiescence of employees is essential to successful privatization. Proposing to sell shares on favorable terms to employees can give help give employees an interest in seeing that privatization goes forward. Moreover, employee stock ownership helps to emphasize the link between employees' rewards and the performance of the company. On the other hand, too much employee stock ownership can hinder enterprise restructuring and bias investment decisions. In addition, like any investor, an employee benefits from diversifying his or her portfolio of assets. A job is typically an important asset for an individual, and a job is subject to firm specific risks, among other risks. Thus an individual gains benefits from diversification by holding stock in companies other than the company in which he or she works. Put simple, if the company at which the individual works shuts do, the employee will not lose both a job and a value of a stock investment in the company.

Strategic industry partner

State enterprises often need new technology and managerial expertise as well as capital. A strategic industry partner is another firm in the same or a similar industry as the

enterprise to be privatized. Attracting such an investor can be crucial to turning around a state enterprise. Such an investor is expected to not just buy shares in the company, but also to play an active role in transferring industry-specific expertise to improve the privatized enterprise's performance. Evaluating bids from potential strategic partners typically involves evaluating many criteria in addition to the aggregate cash value of the bid. Such an evaluation process is more subjective than a straight cash sale and it is more susceptible to corruption. Strategic investors also typically want to be assured of a certain amount of influence over key decisions of the firm. Moreover, because the strategic investor brings non-cash assets to the transaction, selling shares to a strategic investor typically does not maximize the government's revenue from the sale of shares.

Domestic institutional investors

Domestic institutional investors are typically banks, insurance or pension funds, and wealthy individuals. While such investors do not have industry specific expertise, to the extent that a particular investor owns a significant share of stock, the investor has an incentive to devote effort to monitoring and reviewing the performance of the enterprise. When a share offering is complex or includes unusual conditions, marketing to a few institutional investors, who are willing and able to understand the details of the sale may be more appropriate than trying to sell to a larger pool of investors. Some institutional investors expect to sell their shares of a privatized company over a relatively short term, while others may buy and hold shares.

Foreign institutional investors

Foreign institutional investors are likely to have similar characteristics to domestic institutional investors. Nonetheless, there are policy relevant implications of the choice between domestic and foreign institutional investors. Foreign institutional investors may be able to tap larger amounts of capital than domestic institutional investors. Involving foreign investors may also insure world standards in information disclosure and managerial accountability. On the other hand, involving foreign investors potentially will allow foreigners to reap the benefits from an appreciation in the value of the enterprise's. Such a concern is particularly relevant if, for some economically sensible reason, the offering has to be made at a "low" price.

Domestic general public

The general public is often able and interested in investing in an enterprise if shares are appropriately priced and the enterprise presents a credible plan for future growth. Achieving widespread domestic public ownership of shares stimulates the development of domestic financial markets important in raising further capital. In addition, because the success of private enterprises is linked closely to sound general economic policies, achieving widespread share ownership helps to develop a domestic constituency for sound economic policies. However, dispersed share ownership increases the importance of state administrative capacity to prevent various forms of financial market fraud. In addition, widely dispersed share ownership lessens shareholders' incentives to undertake the costs of monitoring and reviewing the enterprise's performance (the free rider problem).

Foreign general public

The foreign general public offers the widest possible base of investors from which to attract investment. However, meeting the regulatory standards for marketing shares to the public in a number of different countries requires considerable managerial expertise. In addition, attracting foreign portfolio investors may increase capital account volatility and macroeconomic risks.

3.5 TYPES OF PRIVATISATION

The following are the types of Privatization:

1. **By section** – namely government sectors which are service based that had been transferred to the private sector.
 2. **By Choice**- mainly government sectors that are partly privatized.
 3. **Trade Oriented**- whereby the government still holds the company but the capital concepts are privatized.
 4. **By Contract**- whereby the private sector would prepare the services for the government.
 5. **By Mortgage**- where by the facilities provided by the government would be rented by the private sector. Example: Malaysia Airlines and TV3
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3.6 DRAWBACKS OF PRIVATIZATION

1. Privatization is expensive and generates a lot of income in fees for specialist advisers such as banks.
2. Public monopolies have been turned into private monopolies with too little competition, so consumers have not benefited as much as had been hoped. This is the main reason why it has been necessary to create regulators (OFWAT, OFGAS etc). This is an important point. It partly depends on how the privatization took place. For example, the railways were privatized in bit of a rush and there might have been other ways to do it so that more competition was created. It partly depends on the market. Some markets are 'natural monopolies' where competition is difficult. For example, it would be very wasteful and expensive to build two sets of track into Liverpool Street just to create some competition. Natural monopolies create a special justification for public ownership in the general public interest.
3. The nationalized industries were sold off too quickly and too cheaply. With patience a better price could have been had with more beneficial results on the government's revenue. In almost all cases the share prices rose sharply as soon as dealing began after privatization.
4. The privatized businesses have sold off or closed down unprofitable parts of the business (as businesses normally do) and so services eg. transport in rural areas has got worse.
5. Wider share ownership did not really happen as many small investors took their profits and didn't buy anything else.

3.7 GLOBALISATION

Globalization (globalization) is a term for the process by which local, regional or national phenomena become integrated on a global scale.

India's economic integration with the rest of the world was very limited because of the restrictive economic policies followed until 1991. Indian firms confined themselves, by and large, to the home market. Foreign investment by Indian firms was very insignificant. With the new economic policy ushered in 1991, there has, however, been change. Globalization has in fact become a buzzword with Indian firms now and many are expanding their overseas business by different strategies. Globalization may be defined as "the growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and of international capital flows, and also through the more rapid and widespread diffusion of technology". Globalization may be considered at two levels Viz, at the macro level (i.e., globalization of the world economy) and at the micro level (i.e., globalization of the business and the firm). Globalization of the world economy is achieved, quite obviously, by globalizing the national economies. Globalization of the economies and globalization of business are very much interdependent.

3.8 REASONS FOR GLOBALISATION

- The rapid shrinking of time and distance across the globe thanks to faster communication, speedier transportation, growing financial flows and rapid technological changes.
- The domestic markets are no longer adequate rich. It is necessary to search of international markets and to set up overseas production facilities.
- Companies may choose for going international to find political stability, which is relatively good in other countries.
- To get technology and managerial know-how.
- Companies often set up overseas plants to reduce high transportation costs.
- Some companies set up plants overseas so as to be close to their raw materials supply and to the markets for their finished products.
- Other developments also contribute to the increasing international of business.
- The US, Canada and Mexico have signed the North American Free Trade agreement (NAFTA), which will remove all barriers to trade among these countries.
- The creation of the World Trade Organization (WTO) is stimulating increased cross-border trade.

3.9 FEATURES OF GLOBALIZATION

The following are the features of the current phase of globalization:

New markets

- Growing global markets in services – banking, insurance, and transport.
- New financial markets - deregulated, globally linked, working around the clock, with action at a distance in real time, with new instruments such as derivatives.
- Deregulation of anti-trust laws and proliferation of mergers and acquisitions.
- Global consumer markets with global brands.

New actors

- Multinational corporations integrating their production and marketing, dominating food production.
- The World Trade Organization - the first multilateral organization with authority to enforce national governments compliance with rule.
- An international criminal court system in the making
- A booming international network of NGOs.
- Regional blocs proliferating and gaining importance – European Union, Association of South-East Asian Nations, Mercosur, North American Free Trade Association, Southern African Development Community, among many others.
- More policy coordination groups – G-7, G40, G22, G77, OECD

New rules and Norms

- Market economic policies spreading around the world, with greater privatization and liberalization than in earlier decades.
- Widespread adoption of democracy as the choice of political regime.
- Human rights conventions and instruments building up in both coverage and number of signatories – and growing awareness among people around the world.
- Consensus goals and action agenda for development.
- Conventions and agreements on the global environment – biodiversity, ozone layer, disposal of hazardous wastes, desertification, and climate change.
- Multilateral agreements in trade, taking on such new agendas as environmental and social conditions.
- New multilateral agreements- for services, intellectual property, communications – more binding on national governments than any previous agreements.
- The multilateral agreements on investment under debate

New Tools of communication

- Internet and electronic communications linking many people simultaneously.
- Cellular phones.
- Fax machines.
- Faster and cheaper transport by air, rail and road.
- Computer-aided design

3.10 STAGES OF GLOBALISATION

There are five different stages in the development of a firm into global corporations.

First stage

The first stage is the arm's length service activity of essentially domestic company, which moves into new markets overseas by linking up with local dealers and distributors.

Second stage

In the stage two, the company takes over these activities on its own.

Third stage

In the next stage, the domestic based company begins to carry out its own manufacturing, marketing and sales in the key foreign markets.

Four stage

In the stage four, the company moves to a full insider position in these markets, supported by a complete business system including R & D and engineering. This stage calls on the managers to replicate in a new environment the hardware, systems and operational approaches that have worked so well at home.

Fifth stage

In the fifth stage, the company moves toward a genuinely global mode of operation.

3.10.1 Globalization Strategies

The various strategies of transiting a firm into global corporation are as follows:

Exporting

Exporting, the most traditional mode of entering the foreign market is quite a common one even now.

Licensing and Franchising

Under international licensing, a firm in one country (the licensor) permits a firm in another country (the licensee) to use its intellectual property (such as patents, trademarks, copyrights, technology, technical know-how, marketing skill or some other specific skill). Franchising is "a form of licensing in which a parent company (the franchiser) grants another independent entity (the franchisee) the right to do business in a prescribed manner.

Contract manufacturing

A company doing international marketing, contracts with firms in foreign countries to manufacture or assemble the products while retaining the responsibilities of marketing the product.

Management contracting

In a management contract the supplier brings together a package of skills that will provide an integrated service to the client without incurring the risk and benefit of ownership. The arrangement is especially attractive if the contracting firm is given an option to purchase some shares in the managed company within a stated period.

Turnkey contracts

A turnkey operation is an agreement by the seller to supply a buyer with a facility fully equipped and ready to be operated by the buyer's personnel, who will be trained by the seller. Turnkey contracts are common in international business in the supply, erection and commissioning of plants, as in the case of oil refineries, steel mills, cement and fertilizer plants etc.

Wholly Owned Manufacturing Facilities

Companies with long term and substantial interest in the foreign market normally establish fully owned manufacturing facilities there. This method demands sufficient financial and managerial resources on the part of the company.

Assembly operations

A manufacturer who wants many of the advantages that are associated with overseas manufacturing facilities and yet does not want to go that far may find it desirable to establish overseas assembly facilities in selected markets. The establishment of an assembly operation represents a cross between exporting and overseas manufacturing.

Joint Ventures

Any form of association, which implies collaboration for more than a transitory period is a joint venture. Types of joint overseas operations are:

- 1. Sharing of ownership and management in an enterprise.**
- 2. Licensing / franchising agreements.**
- 3. Contract manufacturing.**
- 4. Management contracts**

Third country location

When there are no commercial transactions between two nations because of political reasons or when direct transactions between two nations are difficult due to political reasons or the like, a firm in one of these nations which wants to enter the other market will have to operate from a third country base. For example, Taiwanese entrepreneurs found it easy to enter People's Republic of China through bases in Hong Kong.

Mergers and acquisitions

Mergers and acquisitions (M & A) have been a very important market entry strategy as well as expansion strategy. A number of Indian companies have also used this entry strategy.

Strategic alliance

This strategy seeks to enhance the long-term competitive advantage of the firm by forming alliance with its competitors, existing or potential in critical areas, instead of competing with each other. Strategic alliance is also sometimes used as a market entry strategy. For example, a firm may enter a foreign market by forming an alliance with a firm in the foreign market.

Counter trade

Counter trade refers to a variety of unconventional international trade practices which link exchange of goods- directly or indirectly – in an attempt to dispense with currency transactions. Counter trade is a form of international trade in which certain export and import transactions are directly linked with each other and in which import of goods are paid for by export of goods, instead of money payments.

3.11 BENEFITS

The important arguments in favour of globalization are:

- Productivity grows more quickly when countries produce goods and services in which they have comparative advantage.
- Living standards can go up faster.
- Global competition and imports keep a lid on prices, so inflation is less likely to derail economic growth.
- An open economy spurs innovation with fresh ideas from abroad.
- Export jobs often pay more than other jobs.
- Unfettered capital flows give access to foreign investment and keep interest rates low.

3.12 DRAWBACKS OF GLOBALIZATION

Following are the cases against globalization:

- Millions have lost jobs due to imports or production shifts abroad. Most find new jobs that pay less.
- Millions of others fear losing their jobs, especially at those companies operating under competitive pressure.
- Workers face pay cut demands from employers, which often threaten to export jobs.
- Services and white-collar jobs are increasingly vulnerable to operations moving offshore.
- Employees can lose their comparative advantage when companies build advanced factories in low-wage countries, making them as productive as those at home.

Critics of globalization suggest that it will result in damage to the environment, pollution, cultural homogenization, job losses, and an imperialistic imposition of western ideas and values on developing countries.

Ultimately, if globalization continued, there would be no political, cultural, social, or technological divisions, separations, or barriers between nations. The planet would resemble one uniform, equal, homogeneous country.

Also, perhaps people could be better off financially but poorer in other ways. These could be compromises to their happiness or identities through the destruction of the environment, culture, or tradition. These are values economics cannot measure.

3.13 ESSENTIALS FOR GLOBALISATION

They are some essential conditions to be satisfied on the part of the domestic economy as well as the firm for successful globalization of the business.

- **Business freedom**

There should not be unnecessary government restrictions like import restriction, restrictions on sourcing finance or other factors from abroad, foreign investments etc. the economic liberalization is regarded as a first step towards facilitating globalization.

- **Facilities**

The extent to which an enterprise can develop globally from home country base depends on the facilities available like the infrastructural facilities.

- **Government support**

Government support may take the form of policy and procedural reforms, development of common facilities like infrastructural facilities, R & D support, and financial market reforms and so on.

- **Resources**

Resourceful companies may find it easier to thrust ahead in the global market. Resources include finance, technology, R & D capabilities, managerial expertise, company and brand image, human resource etc.

- **Competitiveness**

A firm derives competitive advantage from any one or more of the factors such as low costs and price, product quality, product differentiation, technological superiority, after sales services, marketing strength etc.

- **Orientation**

A global orientation on the part of the business firms and suitable globalization strategies are essential for globalization.

3.14 GLOBALISATION IMPACT ON INDIAN ECONOMY

In India, the process of dismantling trade barriers was started in 1991 and subsequently, every year the Government has been announcing reduction in custom duties and removing quantitative restrictions. It is argued that this shall enable free flow of goods, capital and technology and thus globalization becomes a motivating force for nations to develop themselves at a faster rate. For a developing country like India, it opens access to new markets and new technology. Thus, the import-substitution strategy has been replaced by exported growth during the last decade in India. The recent developments in information and communications technology have further facilitated and accelerated the pace of globalization. International financial markets, trans-border production networks and acceleration in capital flows across national frontiers have been the driving forces leading to greater global integration of the economies.

3.14.1 Impact of Globalization on Indian Economy in Service Sector

As far as the Indian economy is concerned the impact of globalization has been highly positive in almost all spheres of economic and social life and virtually no negative effect. It is only because of opening the hitherto closed, govt.-oppressed and controlled economy to the process of globalization that has helped Indian economy to grow rapidly: in the last 10-12 years, India's economic growth has been high, exports have boomed, incidence of poverty has been reduced, employment has surged, begging by India for economic aid has stopped, long-term inflation rate has gone down, scarcity of goods have disappeared, the quality of products available have improved substantially and overall India has become progressively vibrant and internationally competitive. Indian companies are setting up companies abroad; India has better technological development for the benefit of the common man (mobiles, road transport, cheap clothes, etc - only because of globalization).

Effect of globalization on Indian industry has been very positive, though some industrial firms with the baggage of high cost, inefficient plants and processes inherited from the past because of closed economy's government dictated industrial policies and priorities had to face serious problems in the beginning. But soon most of the industries have become more and more efficient; customer focused and improved their international competitiveness in terms of costs, prices, product quality and variety. Industrial growth has been very high and strong during the past decade because of globalization. Exports have increased tremendously. Indian industries are also expanding abroad. Foreign companies have substantially increased their investments in Indian industries. Wages of industrial labor has increased substantially as they have become very productive. Lock out and strikes have declined to insignificantly low levels because industrial labor is happy. Those who cannot be efficient and past their prime age to retrain themselves in modern methods and processes have been retired with very attractive voluntary retirement schemes. The trade unions are finding it difficult to influence industrial workers into agitation because labor has started benefiting from the positive fallout of globalization on the prosperity and growth of the industrial sector. Talented and merited

labor is commanding premium compensation in the labor market. Several new types of industries have also come up. Small scale industries of the past have fast grown into medium scale companies. Incidence of industrial sickness has gone down drastically. However, the communists will not agree to this view because with industrial workers becoming richer following increasing demand for and the wages of industrial labor resulting from liberalization and globalization.

India has done very little reforms in agriculture to enable private and individual economic initiative that would help harness the benefits of globalization. Despite this govt. created hurdles to globalization, Indian agriculture has benefited substantially from whatever little globalization that has been allowed in Indian agriculture. The farmers that got the exposure to global links of markets, technology and investment, benefited in terms of improving their yields, getting better prices and secured off take. In many areas of the country, tomatoes growers, potato farmers and fruit grower's farmers benefited from tie-up and collaborations with ketchup, potato chips, fruit juices, etc. Indian agricultural exports have grown where Indian farmers in selected pockets are competitive: these include spices made from agricultural produce, flowers, mangoes, other fruits rice, vegetables, pickles, papads, tobacco, etc. The e-choupals network created by an Indian company and the spread of mobile telephones have provided on line market price and climatic information on on-line real-time basis and helped them to get the best prices and sell to the most attractive buyers and brought them freedom from the clutches of the middlemen and traders. Because of the resistance from the traders and the politicians, more and more farmers are not getting the benefits of globalization: vested interests are stopping the entry of more professional and honest buyers of agricultural produce of high quality for supply to urban areas through network of malls. Fishermen in Kerala have increased their incomes using mobile phones to find out the best mandis where the prices are the highest on each day.

There have not been any negative effects of globalization on Indian farming. But faulty and restrictive policies of Indian politicians have made it difficult for farmers to consolidate their holdings for larger scale commercial farming, access to large, high paying buyers with retail chains, support of well-organized transparent mandis not ruled by traders. As a result in many areas farmers have committed suicides because of crop failures and high indebtedness. Using the old British Indian laws of land acquisition, the state govts. are forcing farmers to sell their lands for industries at prices they consider justified rather than asking industrialists and companies to bid for agricultural land which will increase the market prices of land,. Once these policy impediments are removed, globalization will proceed in Agriculture and farming in the proper way and benefit Indian agriculture and farming throughout the country. India does not need all the land under agriculture now for agricultural use: much less area would suffice to feed the nation and export if agricultural productivity can be raise substantially through private investment in agriculture by companies that need agricultural produce for their business growth and India's economic growth.

3.15 REVIEW QUESTIONS

1. Give a detailed account of India's stand on Globalization and Privatization.
2. How do Privatization influences the Indian Economy?
3. The future lies with globalization. Explain.
4. Explain with reference to service sectors the concept of globalization. Critically assess the achievement of the desired results since 1991.
5. Define privatization and trace the history of privatization.
6. Explain the different routes of making privatization.
7. Give your arguments for and against privatization.
8. Explain the stages involved in the economic transition of globalization.

CONSUMER RIGHTS, CONSUMERISM AND BUSINESS

Structure

4.1 Introduction to Consumer Rights

4.1.1 The 8 Consumer Rights

4.2 Consumer Responsibility

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4.5 Plight of the Indian Consumer

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4.1 INTRODUCTION TO CONSUMER RIGHTS

Consumer rights are now an integral part of our lives like a consumerist way of life. They have been well documented and much talked about. We have all made use of them at some point in our daily lives. Market resources and influences are growing by the day and so is the awareness of one's consumer rights. These rights are well-defined and there are agencies like the government, consumer courts and voluntary organizations that work towards safeguarding them. While we all like to know about our rights and make full use of them, consumer responsibility is an area which is still not demarcated and it is hard to spell out all the responsibilities that a consumer is supposed to shoulder. In this chapter, we will give an overview of the 8 consumer rights, their implications and significance for a developing country like India, and also define the various aspects of consumer responsibility.

In the 20th century, the presence and influence of the market grew dramatically in consumer life. We began to purchase things from the market for a price. Soon, mass production and industrial production came into being, giving the consumer world an entirely new dimension. Have you ever wondered how much urban consumers depend on the market for fulfillment of even their basic needs? This over-dependence on the market and the inherent profit motive in mass production and sales has given manufacturers and dealers a good reason to exploit consumers. As a consumer, you would know how market products are constantly under-weight, of inferior quality and do not prescribe to quality standards specified by quality-control agencies. Consumers not only do not get value for their money but also often have to suffer losses and inconvenience due to market manipulations.

4.1.1 The 8 Consumer Rights

In order to safeguard consumer interest, 6 consumer rights were initially envisioned by consumer rights activists of the West, namely:

- **Right to Safety**
- **Right to Information**
- **Right to Choice**
- **Right to be Heard**
- **Right to Redress**
- **The Right to Consumer Education**

These rights were conceptualized in the developed world's consumer context where consumers are wealthy and completely dependent on the market to fulfill their needs. These rights had to be redefined keeping in mind the realities of a developing country like India. Consequently, two very important rights were added viz.:

- **The right to a healthy and sustained environment and**
- **The Right to Basic Needs**

The right to a healthy and sustained environment and

These two rights are very closely linked with the realities of developing countries where environment plays a very important role as a resource and support-structure for the people. In a country like India, a large section of the population looks for food security, assured safe water supply, shelter, education and health services. Most consumers relate very little to imported goods stacked in supermarkets or for choice among latest models of cars, as is the case in the developed world. For India's 1 billion populations, food security and a safe environment are more pressing needs than any other consumer options and rights. The developing country natural resources also serve as a resource base for the developed world's industrial output.

The Right to Basic Needs

Access to food, water and shelter are the basis of any consumer's life. Without these fundamental amenities, life cannot exist. In September 2001, India's stock of food grains were around 60 million tones, yet one third of the Indian population lives below the poverty line and consumers often go hungry or remain severely malnourished, leading to poor health. The recent starvation deaths in Orissa are a case in point. A very crucial objective of the conceptualization and existence of consumer rights is to ensure that consumers have an assured food supply, safe and permanent dwellings, and basic amenities of life like sanitation and potable water, and power supply.

Urbanization is seen as a mark of development but for rural migrant population, living conditions in cities is very poor. The population of cities is growing rapidly in India and after 1988; the percentage of urban poor has been more than that of the rural poor.

Around 20 to 25 per cent of the urban households live in slums, make-shift colonies or refugee settlements due to non-availability of affordable and decent habitat in urban areas. . According to some estimates, in urban areas alone, there is a housing shortage of 17 million units. This has led to a habitat crisis in Indian cities. In rural India, the situation is equally bad, with a large part of the population still living in make-shift dwellings and hutment. With non-permanent housing come lack of sanitation facilities and other amenities like running water and electricity supply. Due to burgeoning population, most people do not have access to dry toilets in rural and urban areas.

Right to Safety

Consumer right to safety is as vast in its purview as the market reach itself. It applies to all possible consumption patterns and to all goods and services. In the context of the new market economy and rapid technological advances affecting the market, the right to safety has become a pre-requisite quality in all products and services. For e.g. some Indian products carry the ISI mark, which is a symbol of satisfactory quality of a product. Similarly, the FPO and AGMARK symbolize standard quality of food products. The market has for long made consumers believe that by consuming packaged food or mineral water, consumers can safeguard their health. This notion has been proved wrong time and again due to rampant food adulteration in market products. Right to food safety is an important consumer right since it directly affects the health and quality of life of consumers. Earlier, the interpretation of the right to safety was limited to electronic products and other such products. Now, its definition has expanded a lot to include safety aspects of new technologies like GM food, food labeling, chemical ingredients in food products etc. In today's scenario of globalization, consumers have no control over where the products or commodities they use come from. For instance, the chocolates or syrups we consume may be manufactured in countries as far as the U.S. or Australia. Consumers in India would have no control over or knowledge of the manufacturing practices of those countries and will have to rely completely on import regulations of the Indian government and food labeling. This makes the consumer right to safety a very important and critical issue for consumers.

Right to Information

Right to information means the right to be given the facts needed to make an informed choice or decision about factors like quality, quantity, potency, purity standards and price of product or service. The right to information now goes beyond avoiding deception and protection against misleading advertising, improper labeling and other practices. For e.g. when you buy a product or utilize a service, you should be informed about a) how to consume a product b) the adverse health effects of its consumption c) Whether the ingredients used are environment- friendly or not etc.

Due to the ever increasing influence of the market and the ever changing scene with price wars and hard-sell techniques, the consumer's right to information becomes even more important. The right to information means much more than simple disclosure of the product's weight or price. A consumer has the right to know how the product has been

prepared, whether it has been tested on animals or not, if environmentally-sound techniques and resources have been used in its production processes, what kinds of chemicals are used in its manufacturing and what could be their impact on consumer health. Clearly, a consumer has to consider a lot of factors before s/he buys a product.

Ideally, a consumer should have knowledge of the entire 'cradle to grave' journey of the product to determine whether it's safe and beneficial for use or no. The 'cradle to grave journey' refers to the processes a product goes through- from the time of it being made out of raw material, the processes of its moulding into its final shape, transportation, labour, ingredients used, to the form in which it ends up on market shelves. It is only when a consumer is aware of the history of the product that he can make informed choices. An example of this is the GM food controversy. GM food is promoted as the answer to world's hunger and malnutrition but its safety for consumers and the environment is yet to be proved. Despite strong lobbying by pro-GM groups and the market, consumers in Europe have campaigned effectively against the entry of GM food into their food chain and markets. There are information and publicity campaigns that have made consumers rally behind a common consumer stand against GM food. As a result, the governments and the European Union have placed strict restrictions on the uses of GM technology in the market or in agriculture.

Recently, it has come to light that most cosmetics like lipsticks, kajal and mascara are tested on animals in laboratories to see whether they have any adverse effects on them or no. There was also a controversy about how Nike shoe company was using sweat labour in South Asian countries, paying its workers abysmally low wages for manufacturing shoes. Similarly, there was a 'McLibel' case against McDonald's alleging that McDonald's generated a lot of unwanted waste due to its excessive packaging and harmed the environment.

The advertising techniques of many products, directly targeting and featuring children have also been questioned. Many parents don't even know that their children are being targeted by market surveyors to determine their consumption habits by collecting data through surveys, interviews and by offering free samples of products.

It is not just the consumers who use information gathering or disseminating techniques and tools to protect their consumer rights. Information dissemination is also used very extensively by advertisers and the market to get their message across to the consumer. Tools and agencies of information like newspapers, print media, television and the Internet are utilized by marketing of consumer products and services. This has made advertising a multi-million dollar industry in India and also world-wide.

Right to Choice

Different interests can interpret the right to choice in different ways. For the developed world consumers, right to choice translates into more and a variety of products to choose from. For e.g. American consumers can choose from 25,000 super market items, 200 kinds of cereals, and read 11,092 magazines. This kind of choice often gives consumers a

sense of well-being and safety and encourages them to believe that abundance leads to good living. The market also perpetuates this line of thought by advertising and promotion gimmicks. The right to choice has a very different definition in developing countries. For a population dependent on the environment for livelihood, the right to choice and other consumer rights need a shift in focus. The focus needs to be on choice of good practices like organic farming and conservation of natural heritage. In cities, people should be able to choose cleaner and safer ways of transportation over polluting ones. Similarly, healthy and fresh food should be chosen over junk food. The right to choose must essentially be a consumer's right to choose a safe and healthy product of good quality over an unsafe or defective product. This can give a consumer immense leverage not just to choose products that are safe but also to influence the practices adopted by the market.

Misinterpretation of choice by market forces has systematically weakened the consumer's position vis-à-vis the market. The market has exploited this situation by interpreting the right to choose and exploit the consumer.

The consumer has been made to believe that more varieties of the same product on the market shelves give him or her the right to choose what s/he wants. In reality, more varieties of the same product just encourage false advertising claims and give the consumer a false sense of choice. Various kinds of shampoos, soaps, and other cosmetics differ merely in color, smell and brand image. Each one of them claims superiority over the other but gives the consumer very little value for money or a better quality product.

Ever since trade liberalization in India started taking place, the consumer world has been witnessing increased availability of exotic fruits, vegetables and imported food items. These days, one can buy imported apples that cost Rs 200 a kilo and syrups, jams, sauces, drinks that are manufactured overseas. However, neither the market nor the consumers pay any attention to the over-consumption of resources as a result and its environmental impact. When products are manufactured in distant lands, they have to be packaged and preserved in a special way to last longer. A lot of resources go into its packaging and transportation. All these facts and their impact are often not made known to consumers and they end up harming the environment and paying an exorbitant price for their consumption choices.

Right to be Heard

The right to be heard means that consumers should be allowed to voice their opinions and grievances at appropriate fora. For e.g. if you have been cheated in the market place or deprived of the right quality of service, your complaint should be heard and given due attention by the authorities. Consumers should also have a right to voice their opinion when rules and regulations pertaining to them are being formulated, like the recent amendments in the Consumer Protection Act. The right to be heard holds special significance in the Indian context because Indian consumers are largely unaware of their rights and passively accept their violation. Even when they have legal recourse, they prefer not to use it for fear of getting embroiled in legal complexities.

To allay consumer fears and to allow them to express their views and grievances, consumer forums have been in existence in India for a long time. Consumers have been approaching these forums and consumer NGOs regarding their problems and complaints.

Right to Redress

Competition is the by-product of the market economy. Everyday, manufacturers are discovering newer ways of cheating and duping consumers. Unscrupulous market practices are finding their way into consumer homes, violating consumer rights and jeopardizing their safety. It is to protect consumer interests that consumers have been given the right to obtain redress. In India, we have a redress machinery called Consumer Courts constituted under the Consumer Protection Act (1986), functioning at national state and district levels. But it has not been made complete use of under due to lack of awareness of basic consumer rights among consumers themselves.

While in the developed world, right to redress is perhaps the most commonly exercised consumer right, in developing countries, consumers are still wary of getting involved in legal redress system. There are consumer courts in India where any consumer can lodge a case if s/he thinks he or she has been cheated. The details of how to lodge a complaint have been explained elsewhere in the manual

Right to Consumer Education

Consumer education empowers consumers to exercise their consumer rights. It is perhaps the single most powerful tool that can take consumers from their present disadvantageous position to one of strength in the marketplace. Consumer education is dynamic, participatory and is mostly acquired by hands-on and practical experience. For instance, a woman who makes purchase decisions for the household and does the actual buying in the marketplace would be more educated about market conditions and 'best buys' than a person who educates himself about the market with the help of newspapers or television. Also, today, it is not just the market or products that a consumer needs to educate him about but s/he also needs to know about company profile, government policies and introduction of new technology.

Market influences have grown so much that not just wholesale and retail sellers but even medical practitioners are falling prey to their pressures. The pharmaceutical industry is one such example. India, with its 1 billion population and largely uneducated consumers, is a very lucrative market for this industry. The pharmaceutical industry, to boost its sales, offers free samples of medicines, freebies, and even free luxury holidays to physicians to influence them to use their brands and give them preference over other brand names. There have been many instances when drugs banned in countries like US, have been prescribed to Indian consumers and are readily available as over-the-counter drugs. It is a sad example of gross violation of consumer trust by medical practitioners. This situation is rampant not just in rural areas but also among educated urban consumers. The reason why the market, in connivance with physicians, is able to exploit consumers is that Indian consumers are not aware of the prevailing situation and do not keep themselves abreast with latest developments taking place around them. Consumer education can play a crucial role in protecting consumers against such In the Indian

context, sustainability and traditional knowledge can play a vital role in empowering consumers but consumers are unable to connect to their knowledge base. Consumer education can rejoin the broken link and make traditional knowledge accessible to consumers again. Some sources of consumer education are past experiences of consumers, information dissemination by government agencies and NGOs, classroom teaching by teachers and informal lessons by parent's dangers.

4.2 CONSUMER RESPONSIBILITY

While we all like to know about our rights and exercise them, we hardly ever accord the same importance and urgency to our consumer responsibilities. Consumer rights and responsibilities are intertwined together and without sharing consumer responsibility, consumers will find it very difficult to enjoy their rights on a long-term basis.

Consumers need to tread cautiously in the market place. While buying a product, ask yourself these questions:

- **Do you really need this product?**
- **For how long would you like to use it? Will it last as long as you would like it to?**
- **What is the health fallout of that product? If it is a food product, does it give you any health benefits? Check the labeling of the product to see the nutritional chart of the product.**
- **You can also empower yourself by knowing the law. For e.g., did you know that ISI mark on bottled mineral water has been made mandatory by the government and now labeling of non-vegetarian ingredient in food products will also mandatory for the industry?**

Consumer responsibility can play a very important role in not only checking the market but also in restricting unnecessary consumption. It is not the sole responsibility of the market or of the government to provide consumers with detailed information. A consumer, on his part, must make every effort to inform himself of the product or service. For example, if a consumer consumes a health product, he must make efforts to inform himself beforehand about its possible side-effects, and must also exercise caution regarding his eating habits, diet and physical exercise, to take full advantage of the product.

Consumer responsibility is based on ethics and rationale. There are no definitive set of consumer responsibilities and a consumer must exercise restraint in consumption to consume responsibly. For example, conservation of the environment cannot be forced upon consumers but a consumer must make a conscious effort to reduce consumption, choose environment-friendly alternatives and conserve energy.

Consumer responsibility needs to be shouldered by different consumer segments. Every segment has its own special consumer profile and consumption patterns. These patterns define the kind of consumer responsibility that a segment must discharge.

Responsibility towards safe waste disposal

Most often we consume without sparing any thought for what's going to be left behind as waste. More and more percentage of waste generated in urban areas today consists of non-biodegradable waste. Urban consumers are making use of plastic, paper and cardboard packaging, disposables batteries, plastic throw-away pens, use and throw nappies, empty cans etc are becoming a common feature of an urban dustbin. India's urban population is around 300 million. By 2011, the total quantity of solid waste generated in urban areas is expected to cross 56 million tones, creating a waste management crisis for urban India. Consumers need to become accountable for their consumption patterns and their serious environmental and economic implications. The 4 R's of consumption (Reduce, Recycle, Refuse and Reuse) are not just a consumer's prerogative but also his consumer responsibility.

Responsibility to endorse safer products (Ecolabelling)

Eco-friendliness is an important criterion in judging a product's feasibility. It is a way of assessing how much damage a product has caused to the environment. 'Eco-mark' is one way of knowing which products conform to environmental standards and are more environment-friendly than others. Ecolabelling is a methodology practiced by many countries in the world, including India. The Indian government has formulated a scheme whereby some categories of products are awarded the 'Ecomark' if they conform to certain standards set by the Ministry of Environment and Forests. Unfortunately, in India, the scheme has not taken off due to consumer apathy and lack of response. The market has manipulated this situation to lobby with the government to make ecolabelling a voluntary scheme, which will allow manufacturers to disclose and cover information at will.

Consumer Bonding

The consumer movement needs active participation of consumers to lobby with the government, pressure the market to deliver better quality, and to support consumer rights campaigns. Empowerment of consumers by NGOs and public campaigns is a two-way process and without continuing consumer support, no campaign can flourish.

The consumers have a number of rights regarding the purchase of things, but at the same time they have some responsibilities too. It means that the consumer should keep a few things in mind while purchasing them. They are as follows:

1. Consumer should exercise his right: Consumers have many rights with regard to the goods and services. They must be aware of their rights while buying. These rights are: Right to safety, Right to be informed, Right to representation, Right to seek redressal, Right to consumer education, etc.

2. Cautious consumer/ Do not buy blindly: The consumers should make full use of their reason while buying things. They should not take the seller's word as final truth. In

other words, while buying consumer must get information regarding the quality, quantity, price, utility etc. of goods and services.

3. Filing complaint for the redressal of genuine grievances: It is the responsibility of a consumer to approach the officer concerned there is some complaint about the goods purchased. A late complaint may find that the period of guarantee/warranty has lapsed. Sometimes, consumers ignore the deception of businessmen. This tendency encourages corrupt business practices.

4. Consumer must be quality conscious/Do not compromise on quality: The consumers should never compromise on the quality of goods. Therefore, they should not buy inferior stuff out of greed for less prices. If the consumers behave like this, there cannot be any protection for them from any quarter. It is also the responsibility of the consumers only to buy goods with the ISI, Agmark, Woolmark, and FPO etc. printed on them. All these symbols indicative of the good quality of the goods.

5. Advertisements often exaggerate/Beware of false advertisement: The seller informs the consumer about their things through the medium of advertisement. The sellers exaggerate the quality of their goods. Therefore, it is the responsibility of the consumers to recognize the truth of advertisement.

6. Do not forget to get Receipt and Guarantee/warranty card: One should always get a receipt or bill for the things purchased. In case a guarantee/warranty card is also offered by seller, it should also be taken. In case the goods purchased are of inferior quality or some defects appears and bothers the customers, these documents will be of great help in settling all kinds of dispute with the seller.

7. Do not buy in hurry: The first important responsibility of consumers is that they should not buy in hurry. It means that the consumers should make an estimate of the things they want to buy their along with their quantity required by them. They should also take in consideration the place from where to buy the things.

4.3 CONSUMER PROTECTION IN INDIA

Consumer protection is essential for a healthy economy. We need Consumer Protection Act for the following:-

- Physical protection of the consumer.
- Protection against deceptive and unfair trade practices.
- Protection against all types of pollution.
- Protection against the abuse of monopoly position and/or restrictive trade practices.
- Protection of enjoying the rights

The Consumer Protection Act was enacted in 1986 based on United Nations guidelines with the objective of providing better protection of consumers' interests. The Act

provides for effective safeguards to consumers against various types of exploitations and unfair dealings, relying on mainly compensatory rather than a punitive or preventive approach. The Act applies to all goods and services unless specifically exempted, and covers the private, public, and cooperative sectors and provides for speedy and inexpensive adjudication. As Under section-6 of Consumer Protection Act, consumer has the following rights:

- The right to be protected against marketing of goods and services which are hazardous to life and property.
- The right to be informed about the quality, quantity, potency, purity, standard and price of goods and services, as the case may be, to protect the consumer against unfair trade practices.
- The right to be assured of access to a variety of goods and services at competitive prices.
- The right to be heard and assured that consumer interest will receive due consideration at appropriate fora.
- The right to seek redressal against unfair or restrictive trade practices or unscrupulous exploitation of consumers.
- The right to consumer education

Under the Consumer Protection Act, 1986 a three-tier, simple, quasi-judicial machinery has been established at the national, State, and district levels for hearing cases raised by consumers. The Act had been amended in 1991 and again in 1993. A comprehensive amendment was last made in 2002 for making the Act effective, functional and purposeful. The amended Act, inter alia, provides for the attachment and subsequent sale of the property of a person not complying with an order.

Although implementation of the Consumer Protection Act can be viewed as a success, there are still serious shortfalls in achieving consumer welfare because of the deficiencies in quality infrastructure in the country. First, there is a regulatory deficit in many products and services which impact on the health, safety and environment of the consumers and mandatory standards have not been prescribed for such products as electrical and electronic goods, IT and telecom equipment, industrial and fire safety equipment and toys. There is a multiplicity of regulatory/standardization/conformity assessment bodies and proliferation of certification and inspection bodies. At present, the Quality Council of India (QCI) is the main accreditation body for conformity assessment bodies taking up product or system certification or for inspection bodies, and the National Accreditation Board for Laboratories performs the same function for laboratories. However, there is no compulsion on the conformity assessment bodies, inspection bodies or laboratories to obtain accreditation, thus creating a lack of certainty about the existence of quality products, systems, inspections and laboratories. Laboratory infrastructure is weak in terms of international norms. Quality professionals lack the skills to guide quality improvement efforts in industry. There is apathy among businesses towards standardization in general, and lack of awareness among them about the impact of standards on quality, competitiveness, and profitability. There is absence of consumer demand for quality goods and services primarily because of lack of awareness among

them regarding quality issues. In short, there is absence of a quality culture in the country. At a time when tariff barriers are falling worldwide as a result of multilateral trade negotiations and in the context of Foreign Trade Agreements (FTAs), and technical barriers to trade have become more significant as determinants of trade flows, urgent action has become necessary to correct the situation in the country as described above. If the quality of Indian products and their conformity with international standards is to be accomplished by Indian producers, the impulse must be generated from within the country. Nothing can have a more powerful impact on the producers than the demand for quality products by quality-conscious domestic consumers.

4.4 EXPLOITATION OF CONSUMERS

Consumers are, however, by and large, practically denied most of these rights. They are a large number of restrictive and unfair trade practices. A situation has developed in which the public have become victims of false claims for products blatantly advertised. Behavioral science is extensively applied to marketing to ruthlessly, exploit the consumers by simulating the weak points and soft corners of their mind. Misleading, false or deceptive advertisements are quite common. Many a time the advertisements deliberately give only half to give a different impression than is the actual fact. Thus, advertisements may, be misleading because things that should be said have not been said, or, because advertisements are composed or purposefully presented in such a way as to mislead. The situation is such that misrepresentations about the quality of a product or the potency of a drug or medicine can be projected without much risk.

High-Powered Expert Committee on Companies and MRTP Acts, popularly known as Committee, points out, fictitious bargains are another common form of deception. Many devices are used to lure buyers into believing that they are getting something for nothing or at a nominal value for their money. Prices may be advertised as generally reduced and cut when in reality the goods may be sold at sellers' regular prices.

Thus apart from the monopolistic and restrictive trade practices that have the effect of competition and increasing the market imperfections to the common detriment, consumer exploitation through unfair trade practices that mislead or dupe the customers has become widespread. And it is this situation that has largely led to the growth of consumerism.

The some consumer exploitation is given below:

1. Underweight and under measures
2. High Prices
3. Sub Standard Quality
4. Duplicate Articles
5. Rough Behavior and undue conditions
6. Lack of safety devices
7. Poor or inadequate after sales service
8. Adulteration of foods (use of unpermitted colours)

9. Sales of medicines after expiry date.
10. Spurious drugs (Sub-standard drugs)
11. Supply of blood from a blood bank infected with AIDS or other diseases.
12. Advertisement with false claims
13. Shortage of weight and quality Excessive price.
14. Death of a person due to medical negligence of a doctor.

4.5 CONSUMERISM

In economics, **consumerism** refers to economic policies placing emphasis on consumption. In an abstract sense, it is the belief that the free choice of consumers should dictate the economic structure of a society.

Philip Kotler defines Consumerism as “a social movement seeking to augment the rights and powers of the buyers in relation to sellers”. Boyd and Allen state that “although often abused as a term, consumerism may be best defined as the dedication of those activities of both public and private organizations which are designed to protect individuals from practices that impinge upon their rights as consumers.”

In his speech delivered at the 44th Annual General Meeting of Hindustan *Lever Ltd.* in 1977 the Chairman, Mr. T. Thomas, rightly pointed out: “While the producer has the power or the right to design the product, distribute, advertise and price it, the consumer has only the power of not buying it. One may argue that the producer runs the greater risk in spite of having several rights because the veto power remains with the consumer. However, the consumer often feels that while he has the power of veto, he is not always fully equipped to exercise that power in his best interests. This situation may be the effect of lack of information, too much indigestible information or even misinformation from one or several competing producers. This problem facing the consumer has led to 'consumerism'. It is worthwhile to note that consumerism, like several other social movements, e.g., independence movement Civil Rights movement, etc., has been the result of a social conflict and cannot, therefore, be wished away. It will be with us till the conflict facing the consumer is resolved”

Consumerism, interpreted as a collective endeavor of the consumers to protect their interests, is a manifestation of the failure of the business, including that of the public sector, and the government to guarantee and ensure the legitimate rights of the consumers.

4.6 PLIGHT OF THE INDIAN CONSUMER

An examination of the important problems facing the Indian consumer would make clear the need for more effective government intervention and consumer movement to safeguard consumer rights.

The following factors make the plight of the Indian consumer miserable.

1. Short supply of many goods and services, especially of essential items, is a very serious problem afflicting the Indian consumer. The demand-supply imbalance has produced all the associated evils of profiteering, hoarding and black-marketing, corruption, nepotism, irresponsiveness and arrogance towards consumers. Although the situation has as a result of the increase in competition due to liberalization, it is still far from satisfactory.

2. The Indian consumer has also been the victim of lack of *effective or workable*. "Competition among sellers, even though imperfect, may be regarded as effective or workable if it offers buyers real alternatives sufficient to enable them, by shifting their purchase from one seller to another, substantially to influence quality, service and price. Competition, to be effective, need not involve the standardization of commodities; it does however, require the ready substitution of one product for another; it may manifest itself in differences in quality and service as well as in price. Effective competition depends also upon the general availability of essential information; buyers cannot influence the behavior of sellers unless alternatives are known. It requires the presence in the market of several sellers, each of them possessing the capacity to survive and grow, and the preservation of conditions which keep alive the threat of potential competition from others . The test of effectiveness and workability in competition among sellers is thus to be found in the availability of buyers of genuine alternatives in policy among their sources of supply."

(The above two points should not be confused as one and the same. Short supply refers to quantitative insufficiency whereas lack of effective competition refers to dearth of enough alternatives.)

3. Many products with which consumers in advanced countries are quite familiar are still new to a very large segment of the Indian consumers. The unfamiliarity of the consumers with product features makes the sale of substandard, inferior or even defective products easier in India than in advanced countries.

4. Due to low literacy levels and unsatisfactory information flows, the Indian consumers, by and large, are not conscious of all their rights. This encourages irresponsible and unscrupulous business attitudes and tactics.

5. It has been said that the legal process in India is comparatively time-consuming cumbersome. This discourages the consumers from seeking the redressal of their grievance by means of the judicial process.

6. Consumerism in India is not well organized and developed.

7. Though the public sector had been developed and expanded to serve the public interest by providing effective competition to the private sector, increasing production, improving distribution, etc., it failed to produce benefits that were commensurate with the investment. It is an irony that though consumer welfare is an avowed objective of the

public sector, in certain areas the poor performance of the public sector monopolies has made the plight of the consumer more miserable. Some of them have even been charged with unfair trade practices.

8. Though there are a number of laws to safeguard the interests of consumers, they are not effectively implemented and enforced to achieve the objectives.

The above factors call for effective State intervention and consumerism to ensure the rights of consumers.

4.6 REVIEW QUESTION

1. Define Consumerism
2. Give the relevant provisions of the MRTP Act.
3. Discuss the working of three tier machinery for the redressal of consumer grievances under the Consumer Protection Act
4. Explain in detail about consumer rights
5. Explain the rights of Consumers under the Consumer Protection Act, 1986.

BUSINESS AND SOCIETY

Structure

- 5.1 Social Environment
- 5.2 Poverty and Poverty Alleviation Programs
- 5.3 Labour and Employment
- 5.4 Women and Child Labour
- 5.5 Education, Health, Population and Family Welfare
- 5.6 Corporate Governance
- 5.7 Corporate Social Responsibility
- 5.8 Business Ethics
- 5.9 Case Study
- 5.10 Review Questions

5.1 SOCIAL ENVIRONMENT

The social sector is viewed as one of the most important sectors in the developing economies of the world. It involves various programs and policies of the Government which are aimed at improving the standard of living of the citizens of that country through better availability of public services.

The social sector broadly refers to the services available in the following fields:

- Poverty and Poverty alleviation programs;
- Labour and Employment
- Development of women and children
- Education
- Health
- Population and family welfare
- Empowerment of the socially disadvantaged
- Public amenities in rural and urban areas

The main problem that is faced by most of the developing countries of the world is their ever growing high population, leading to high pressure on the land and agricultural sector. In such a scenario, the role of the government in providing the basic facilities, to the entire population, assumes a huge significance.

According to the UN Human Development Index (UNHDI), a country is ranked on its ability to provide to its citizens the three basic amenities of life, viz., longevity and health, education and a decent standard of living. These form an integral part of the social sector and thus, the relative level of social support for the citizens of that country can be measured using these indicators.

One of the main objectives of this unit is to learn the problems and issues in the social sector with a global perspective and discuss the state of the social sector in India which, in recent times, has shown rapid economic development, fuelling speculation about its possible entry into the league of developed nations. Let us study the prevailing practices in India since the country faces the problem of population explosion, which leads to the need for a social security system.

5.2 POVERTY AND POVERTY ALLEVIATION PROGRAMMES

According to the World Bank, poverty is hunger, lack of shelter, inability to access medical help and education. Poverty is powerlessness, lack of representation and freedom. Existence of poverty calls for action, a call to change the world so that many more may have enough to eat, adequate shelter, access to education and health.

Poverty can be looked at through various indicators like levels of income and consumption social indicators, and indicators of vulnerability to risks and of socio-political access. Mostly poverty measurement has been focused on the income levels. It is important to study other dimensions of poverty as well. The World Bank has prepared a report on this-'World Development Report (WDR). It emphasizes the need for social development based on education, health, access to services, infrastructure and so on.

Trends in Poverty over Time

Living Standards have improved over the last few decades. The proportion of the developing world's population living in extreme economic poverty, using the reference lines defined earlier, had fallen from 28 per cent in 1990 to 21 per cent in 2002. Infant mortality rates in low and middle-income countries have fallen from 86 per 1,000 live births in 1980 to 60 in 2002 while life expectancy had risen from 60 to 65 between 1980 and 2002. Adult literacy has also improved, though serious gender disparities remain. Male adult literacy (Age 15 and over) rose from 78% to 83% between 1990 and 2002 while female literacy rates rose from 62% to 70%.

Wide Regional Disparities are still persistent. There has been rapid growth in China and Asia and Pacific region in the recent years. But in Sub-Saharan Africa, GDP per capita shrank and poverty raised from 41 per cent in 1981 to 46 per cent in 2001.1

Millennium Development Goals (MDGs)

Although the overall poverty levels have fallen, the cause of worry is that this development is uneven across the world. Responding to such concerns in September 2000, 189 countries signed the Millennium Declaration, which led to the adoption of the Millennium Development Goals (MDGs). The MDGs are a set of eight goals for which 18 numerical targets have been set and over 40 quantifiable indicators have been identified. India and China are signatories to Millennium Development Goals.

The goals are:

- Eradicate extreme poverty and hunger;
- Achieve universal primary education;
- Promote gender equality and empower women;
- Reduce child mortality;
- Improve maternal health;
- Check the spread of HIV / AIDS, malaria, and other diseases;
- Ensure environmental sustainability;
- Develop a global partnership for development.

Based on the above mentioned goals and the expected scenario, the Global Monitoring Report, 2004 suggests areas for particular attention.

Priorities for Developing Countries

- Improving the business environment for private sector activity;
- Strengthening capacity in the public sector and improving the quality of governance;
- Scaling up investment in infrastructure and ensuring its effectiveness.

Priorities for Developed Countries

- Sustaining stable and strong growth in the global economy;
- Providing more and better aid;
- Improving policy coherence for development.
-

Priorities for International Financial Institutions

- Refining and strengthening institutional roles in low-income countries;
- Furthering progress on the results agenda;
- Improving selectivity and coordination of agency programs.

India

In India, poverty is estimated by the Planning Commission on the basis of large-scale quinquennial Sample Survey on Household Consumer Expenditure conducted by the National Sample Survey Organization (NSSO). The last official estimates of poverty relate to 1999-2000. There has been significant decline in the people living below the poverty line (BPL) from 51.3 per cent in 1977-78 to 26.1 per cent in 1999-2000. But the country suffers from wide regional disparities and between rural and urban population. The Tenth Plan (2002-2007) has a target of reduction in poverty ratio.

The strategy for poverty alleviation follows a two-fold process. First is to provide greater opportunity to poor to participate in the growth process and the second is to have social security programs which are specifically strengthened for the weaker sections of the society. The National Rural Employment Guarantee Bill, 2004 was introduced in Parliament in December 2004.

Some of the poverty alleviation programs being carried out are National Food for Work Program, Swarnajayanti Gram Swarozgar Yojana (SGSY), Sampoorna Grameen Rozgar Yojana (SGRY), Pradhan Mantri Gramodaya Yojana (PMGY) and Rural Employment Generation Program (REGP) to name a few.

5.3 LABOUR AND EMPLOYMENT

It is important to provide work opportunities to people as this helps them earn income to meet the material needs and provide them with a sense of dignity and purpose of life. Efficient labour markets contribute to the cause of poverty reduction while contributing to the economic growth and development.

The global employment situation improved slightly in 2004. Global unemployment stood at 184.7 million at the end of 2004, down from 185.2 million in 2003. It marks only the second time in the past decade that there was a year-over-year decline in total unemployment. In addition, the global employment-to-population ratio stabilized in 2004 at 61.8 per cent, from 61.7 in 2003.

Some of the major issues that would be affecting the labour market policies in the following years are:

- Tsunami and earthquake disaster
- HIV/AIDS
- Promoting the agriculture sector for poverty reduction
- Addressing the employment impact of '*outsourcing*'
- Creating better jobs in the informal economy
- Tackling the youth employment challenge

The International Labour Organization has identified 20 indicators of the Labour Market. They are:

- Labour force participation rate;
- Employment-to-population ratio;
- Status in employment;
- Employment by sector;
- Part-time workers;
- Hours of work;
- Informal sector employment;
- Unemployment;
- Youth Unemployment;
- Long-term Unemployment;
- Unemployment by educational attainment;
- Time-related underemployment
- Inactivity rate;
- Educational attainment and illiteracy;
- Manufacturing wage trends;
- Occupational wage and earning indices;
- Hourly compensation costs;
- Labour productivity and unit labour costs;
- Labour market flows;
- Poverty and income distribution

Labour markets work best when there is an institutional environment that allows adjustment flexibility for firms while ensuring income, social and employment protection for workers. In the developed world, the maintenance of employment protection rights and therefore, also employment stability is at the core of the employment system. It appears that there is a trade-off between employment and social protection meaning that we need to carefully look at the employment protection and labour protection policies. The developing countries, as they are operating very often in unstable environments, have to find ways to stabilize and gradually formalize their labour markets further in order to climb higher up the development ladder. Labour market stabilization implies the introduction of labour standards and labour market institutions.

India

As per the results of the 55th Round of the National sample survey, the rate of growth of employment on Current Daily Status (CDS) basis declined from 2.7 per cent per annum in 1983-1994 to 1.07 per cent per annum in 1994-2000. One of the reasons for the decline in the overall growth rate of employment can be attributed to the fact that there has been a near stagnation of employment in agriculture. As a result, share of agriculture in total employment dropped from 60 per cent in 1993-94 to 57 per cent in 1999-2000 and 55% in 2004-05. On the other hand, employment growth in all the sub-sectors within services (except community, social and personal services) exceeded 5 per cent per annum. It is important that the growth rate of employment should increase consistently. Some of the strategies which can be followed are:

- Special emphasis to promote public investment in rural areas for absorbing unemployed labour force for asset creation;
- Identification of reforms in the financial sector to achieve investment targets in the Small and Medium Enterprises (SME) sector;
- Large-scale employment creation in the construction sector, especially for the unskilled and semi-skilled;
- Necessary support" to services sectors and greater focus on agro-processing and rural services.

5.4 WOMEN AND CHILD LABOUR

Women in the Workforce: Quantitative increases in women's economic participation in the past two decades have not generally been matched, by qualitative improvements. One of the priorities of the Chinese government is, therefore, to improve the quantity and quality of employment for women. In addition, the Copenhagen Declaration on Social Development commits governments to "formulating or strengthening policies and practices to ensure that women are enabled to participate fully in paid work and in employment".

India

Employment of women in the organized sector (both public and private) in 2004 at 4.99 million constituted 18.8 per cent of the total organized sector employment compared to 18.1 per cent in 2002. Several initiatives are being taken to upgrade skills of women through training.

Child Labour

There are thousands of children engaged in child labour. Of those, most of them work in hazardous situations or conditions, such as in mines, with chemicals and pesticides in agriculture or working with dangerous machinery. They are everywhere but invisible, toiling as domestic servants in homes, laboring behind the walls of workshops or hidden from view in plantations.

Child Work

Children's participation in economic activity that does not negatively interfere with education can be positive. Work that does not interfere with education (light work) is permitted from the age of 12 years under the International Labour Organization (ILO) Convention 138.

Child Labor

This means all children below 12 years of age working in any economic activities, those aged 12 to 14 years engaged in harmful work, and all children engaged in the worst forms of child labour.

India

Interpolation of census figures by the National Labour Institute indicates that out of 203 million children between the ages of 5 and 14, 116 million are in school, 12.6 million are in full-time employment, and the status of 74 million is unknown. Most, if not all, of the 87 million children, not in school, do housework, work on family farms, work alongside their parents as paid agricultural labourers, work as domestic servants, or are otherwise employed. As many as 100 million boys and girls are believed to be working in homes and factories across India, many under conditions akin to slavery.

Government has adopted two schemes, namely, National Child Labour Project Scheme (NCLP) and Granting Aid to voluntary organizations for taking up action-oriented programs in the field of rehabilitation of child labour.

5.5 EDUCATION, HEALTH, POPULATION AND FAMILY WELFARE

Education: Promoting education is central to the World Bank's mission of poverty reduction. The World Bank has been helping advance education in developing countries since 1963 and today remains the world's single largest provider of external funding for education.

The Bank's support for education has a dual focus: to help countries achieve universal primary education and equally, build the skills imparted at the secondary and tertiary levels, which are vital to compete in today's advanced knowledge-driven global markets.

As of June 30, 2004, 89 low and middle-income countries were implementing a total of 142 World Bank-financed education projects worth about \$8.5 billion. Lending for education amounted to \$1.7 billion in the year ended June 30, 2004. Helping countries put in place sound education policies is a top priority, with emphasis on education quality.

As with all World Bank assistance, lending is only one part of a broader package of the services. The Bank complements its finance with policy advice; analysis; sharing of global knowledge and best practice; technical assistance and capacity building; and support for consensus-building. The Bank is also at the forefront of global efforts to advance education. The past few years have seen marked progress toward 'Education for All'-an international commitment first made in 1990, as the Bank has worked vigorously with country and global partners to map out the path to the 2015 goal and put in place the Fast-Track Initiative.

India

The primary aim of the government in this regard is to achieve 100% literacy rates among the population. Although literacy has been growing constantly in India since

Independence, it has only reached a level of 64.8%, as indicated by the last census. This is primarily because the population has been growing at a faster rate, but the absolute number of illiterates has decreased in the last census as compared to the previous years. The gender gap in literacy is also reducing as is the rural-urban divide in this area.

The education policy is divided under the following heads in India:

- **Elementary Education;**
- **University and Higher Education;**
- **Technical and Professional Educational;**
- **Adult Education**

Health, Population and Family Welfare: One of the main problems facing the world today is that of the spreading AIDS epidemic. International! Health organizations are concerned about the incidence of HIV in a large percentage of the population in African and Asian countries. Large amounts of money are being spent in order to spread information about the fatal nature of the disease and to support research working to find a cure for it. The growing population in developing and less developed countries is also a cause for concern for these organizations since a large amount of funds is required to support the social infrastructure needed to deal with this phenomenon.

India

Although the health services have improved over the past few decades, the focus has shifted towards providing healthcare to the underprivileged sections of the society. Some of the other issues that need to be addressed are the shortages of manpower, services and drugs in many hospitals as well as the large rural-urban divide in the availability of health services.

Some of the issues addressed under the 10th Plan were emergency and disaster management (in situations like the tsunami that had hit the south and south-east Asia), health insurance for the needy ~d free emergency (life-saving) services to all those below the poverty line.

Several centrally-sponsored schemes for the control of infectious diseases like malaria, dengue, encephalitis, tuberculosis, leprosy and AIDS were introduced. Also, measures were introduced to deal with non-communicable diseases like blindness, cancer and mental disorders.

By 2050, India is expected to be the most populated country in the world. In order to combat this problem, effective steps have to be designed. The current growth in the population is due to high fertility (contraception needs are unmet) and a very high proportion of the population in the reproductive age group. The long term aim is to achieve population stabilization by 2045.

Conclusion

The social sectors in India have to work towards the upliftment of the people. In spite of the economic growth some of the important issues that need to be addressed are:

- Reduction in the number of people living below the poverty line;
- Improving working conditions and providing employment opportunities;
- Stabilization of population;
- Development of women
- 100% literacy among the population
- Immunization of all children and eradication of diseases like polio, tuberculosis, and addressing the issue of AIDS

The social sector is one of great importance, since it deals with the living standards and facilities available to people, India's most important resource.

Corporate Social Responsibility (**CRS**) can be described as an approach by which a company:

- Recognize that its activities have a wider impact on the society and that development in society, in turn, supports the company to pursue its business successfully; and
- Actively manage the economic, social, environmental, and human rights of its activities.

This approach is derived from principles of sustainable development and good **“Corporate Governance”**

5.6 CORPORATE GOVERNANCE

Corporate failures and widespread dissatisfaction with the way many corporate functions have led to the realization, globally, of the need to put in place a proper system for corporate governance. Corporate governance is concerned with holding the balance between economic and social goals and between individual and communal goals.

The governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interest of individuals, corporations, and society. The incentive to corporations and to those who own and manage them to adopt internationally accepted governance standards is that these standards will help them to achieve their corporate aims and to attract investment.

The incentive for their adoption by states is that these standards will strengthen the economy and discourage fraud and mismanagement.

Relevance

At least three reasons have triggered off concern in corporate governance in our country.

- Since 1991, the country has moved into liberalized economy and one of the victims of the market-based economy is transparent fair business practice. Several instances of mismanagement have been alleged, with some well-known and senior executive being hauled up for non-performance and /or non-compliance with legal requirements.
- Both domestic as well as foreign investors are becoming more demanding in their approach towards the companies in which they have invested their funds. They seek information and want to influence decisions.
- Interests of non-promoter shareholder and those of small investors are increasingly being undermined. Several MNCs have sought to set up 100 percent subsidiaries and transfer their businesses to them .In many cases, there was no thought of consultation with non-promoter shareholders.

In this context, some norms of behavior to ensure responsive behavior are of great help. Hence, corporate governance is important.

Focus

Corporate governance is concerned with the values, vision and visibility. It is about the value orientation of the organization, ethical norms for its performance, the direction of development and social accomplishment of the organization and the visibility of its performance and practices. Corporate management is concerned with the efficiency of the resources use, value addition and wealth creation within the broad parameters of the corporate philosophy established by corporate governance.

Importance

- Studies of firms in India and abroad have shown that markets and investors take notice of well-managed companies, respond positively to them, and reward such companies, with higher valuations. In other words they have a system of good corporate governance.
- Strong corporate governance is indispensable to resilient and vibrant capital markets and is an important instrument of investor protection.
- Corporate governance prevents insider trading.
- Under corporate governance, corporates are expected to disseminate the material price sensitive information in a timely and proper manner and also ensures that till such information is made public, insiders abstain from transacting in the securities of the company.
- The principle should be 'disclose or desist'. Good corporate governance, besides protecting the interests of shareholders and all other stakeholders, contributes to the efficiency of a business enterprise, to the creation of wealth and to the country's economy.

- Good corporate governance is considered vital from medium and long term perspectives to enable firms to compete internationally in sustained way and make them, not only to improve standard of living materially but also to enhance social cohesion.

Pre-Requisites

A system of good corporate governance requires the following:

- A proper system consisting of clearly defined and adequate structure of roles, authority and responsibility.
- Vision, principles and norms, which indicate development path, normative considerations, and guidelines and norms for performance.
- A proper system for guiding, monitoring, reporting and control.

5.7 CORPORATE SOCIAL RESPONSIBILITY (CSR)

Social responsibility is the obligation of decision-makers to take actions, which protect and improve the welfare of society as a whole along with their own interests. Every decision the businessman takes and every action he contemplates have social implications.

Be it deciding on diversification, expansion, opening of a new branch, and closure of an existing branch or replacement of men by machines, the society is affected in one way or the other. Whether the issue is significant or not, the businessman should keep his social obligation in mind before contemplating any action.

Arguments for Social Responsibility

- Business has to respond to the needs and expectations of society;
- Improvement of the social environment benefits both society and business;
- Social responsibility discourages additional governmental regulation and intervention;
- Business has a great deal of power, which should be accompanied by an equal amount of responsibility;
- Internal activities of the enterprise have an impact on the external environment;
- The concept of social responsibility protects interests of stockholders;
- Social responsibility creates a favorable public image;
- Business has the resources to solve some of society's problems;
- It is better to prevent social problems through business involvement than to cure them.

Arguments against Social Reasonability

- Social responsibilities could reduce economic efficiency;
- Social responsibility would create excessive costs for business;
- Weakened international balance of payments;
- Business has enough power, and social involvement would further increase its power and influence;
- Business people lack the social skills necessary to deal with the problems of society;
- Business is not really accountable to society.

Social Stakeholders

Managers, who are concerned about corporate social responsibility, need to identify various interest groups which may affect the functioning of a business organization and may be affected by its functioning. Business enterprises are primarily responsible to six major groups:

- Shareholders;
- Employees;
- Customers;
- Creditors, suppliers and others;
- Society; and
- Government.

These groups are called interest groups or social stakeholders. They can be affected for better or worse by the business activities of corporations.

Social Responsiveness

Social responsiveness (SR) is “the ability of a corporation to relate its operations and policies to the social environment in ways that are mutually beneficial to the company and to society”.

In other words, it refers to the development of organizational decision processes whereby managers anticipate, respond to, and manage areas of social responsibility. The need to measure the social responsiveness of an organization led to the concept of social audit. The social responsiveness of an organization can be measured on the basis of the following criteria:

- Contributions to charitable and civic projects;
- Assisting voluntary social organizations in fund-raising;
- Employee involvement in civic activities;
- Proper reuse of material;
- Equal employment opportunity;

- Promotion of minorities;
- Direct corporate social responsiveness investment;
- Fair treatment of employees;
- Fair pay and safe working conditions;
- Safe and quality products to consumers;
- Pollution avoidance and control

5.8 BUSINESS ETHICS

The two issues - an organization's social responsibility and responsiveness- ultimately depend on the ethical standards of managers. The term ethics commonly refers to the rules or principles that define right and wrong conduct. Ethics is defined as the "discipline dealing with what is good and bad and with moral duty and obligation". Business ethics is concerned with truth and justice and has a variety of aspects such as expectations of society, fair competition, advertising, public relations, social responsibilities, consumer autonomy, and corporate behavior in the home country as well as abroad.

Types of Business Ethics

Moral Management: Moral management strives to follow ethical principles and precepts, moral managers strive for success, but never violate the parameters of ethical standards. They seek to succeed only within the ideas of fairness, and justice.

Moral managers follow the law not only in letter but also in spirit. The moral management approach is likely to be in the best interests of the organization, long run.

Amoral Management: This approach is neither immoral nor moral. It ignores ethical considerations. Amoral management is broadly categorized into two types – intentional and unintentional.

- Intentional amoral managers exclude ethical issues because they think that general ethical standards are not appropriate to business;
- Unintentional amoral managers do not include ethical concerns because they are inattentive or insensitive to the moral implications.

Immoral Management: Immoral management is synonymous with "unethical" practices in business. This kind of management not only ignores concerns, it is actively opposed to ethical behavior.

Need for Business Ethics

- Ethics corresponds to basic human needs. It is human trait that man desires to be ethical, not only in his private life but also in his business. These basic ethical need compel the organizations to be ethically oriented;
- Values create credibility with public. A company perceived by the public to be ethically and socially responsive will be honored and respected. The management has credibility with its employees precisely because it has credibility with the public;
- An ethical attitude helps the management make better decisions, because ethics will force a management to take various aspects- economic, social, and ethical in making decisions;
- Value driven companies are sure to be successful in the long run, though in the short run, they may lose money;
- Ethics is important because the government, law and lawyers cannot do everything to protect society;

Ethical Guidelines

- **Obeying the Law:** Obedience to the law, preferably both the letter and spirit of the law;
- **Tell the Truth:** To build and maintain long-term, trusting and win-win relationships with relevant stockholders;
- **Uphold Human Dignity:** Giving due importance to the element of human dignity and treating people with respect;
- **Adhere to the Golden Rule:** “Do unto others as you would have others do unto you”;
- **Premium Non-Nocere: (Above all, do no harm);**
- **Allow Room for participation:** Soliciting the participation of stakeholders rather than paternalism. It emphasizes the significance of learning about the needs of stakeholders;
- **Always Act when You have Responsibility:** Managers have the responsibility of taking action whenever they have the capacity or adequate resources to do so.

Tools for Ethical Management

- **Top Management Commitment:** Managers can prove their commitment and dedication for work and by acting as role models through their own behaviors;
- **Codes of Ethics:** A formal document that states an organization’s primary values and the ethical rules it expects employees to follow. The code is helpful in maintaining ethical behavior among employees;
- **Ethics committees:** Appointment of an ethics committee, consisting of internal and external directors is essential for institutionalizing ethical behavior;

- **Ethics Audits:** Systematic assessment of conformance to organizational ethical policies, understanding of those policies, and identification of serious deviations requiring remedial action;
- **Ethics training:** Ethical training enables managers to integrate employee behavior in ethical arena with major organizational goals;
- **Ethics Hotline:** A special telephone line that enables employees to bypass the normal chain of command in reporting their experiences, expectations and problem. The line is usually handled by an executive appointed to help resolve the issues that are reported.

5.9 CASE STUDY

Case 1: CSR at Bank of India*

At Bank of India, corporate social responsibility is basically the care and concern for the deprived in particular and the community at large. Social responsibility is a function of the banking industry where by the Bank focuses on those below poverty line and the communities that qualify for schematic lending under the various government sponsored programs. The focus is on ensuring that they become self-sufficient and can achieve the desired goals to improve their living standards. The Bank has a policy of recruiting the blind and disabled and "also has a committee to monitor and prevent any sexual harassment at the work place. Employees' always volunteer to support NGOs in noble causes such as Eye donations/ Blood donation camps.

The top management not only involves in such a cause but also actively supports it. Well known NGOs who have been on the scene for quite a number of years and doing services to the community over the years are supported in their cause. The programs are monitored by the zonal offices spread over 43 zones that ensure the end of the funds donated to the NGOs. The relationship with some of the NGOs is on a continuous basis like that with the cancer foundation. The bank is truly a Bank of India. As the name indicates, with over 2600 branches and 43 zonal offices and has a good representation both in metro, urban and rural India. It is, therefore, natural that CSR should spread across state borders and is not limited to where the Bank is headquartered.

Business ethics and governance are separate issues. The money contributed towards CSR activities are monitored by the concerned zonal offices and the NGOs are asked to submit receipts and photographs justifying end use of funds. Employees have always contributed whenever there has been a major disaster by donating a day's wages, which along with the Bank's contribution, collectively works out to a few million rupees. Their employees are involved in a systematic monitoring of the activities for which the funds have been donated. The objective is to ensure that there is total involvement of both the management and the employees while the mission would be to succeed in making life better for poorest of the poor and the downtrodden.

As part of its centenary celebrations, the Bank of India has adopted 101 villages. Employees too are very considerate when it comes to serving a social cause and the Officers' association and the Unions have always been organizing blood donation drives,

adoption of village and free cancer detection camp.

***Source: Compiled from 'The Economic Times', January 18, 2006.**

Case 2: Bharat Petroleum and Social Responsibility

Do we reach out to the people? Are our efforts visible in the far flung villages in backward areas of the country? Bharat Petroleum (BP) believes that the answer to these questions is yes. Bharat Petroleum energizes the lives of Indians in one way or the other. The corporation has invested heavily in staff, customers, stakeholders and society and this is "because they care".

The essence of Corporate Social responsibility is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of work force, their families as well as society at large.

Any business needs a stable social environment that provides a predictable climate for investment and trade. At the same time society also has expectations from the business. In this manner, businesses and society are interdependent and businesses must take full account of the societal expectations. Increasing regulatory pressures could be one of the reasons for undertaking CSR activities. However, in this day and age, CSR is increasingly being viewed not only as making good business sense, but also as contributing to long-term prosperity of the companies and ultimately their survival.

The challenge for successful company in Indian and global economy is to build and maintain efficient, effective and fair relationship with its global and local stakeholders. An increased brand value, greater access to finance, stronger risk management and corporate governance, healthier and safer work place, motivated people, customer loyalty and enhanced confidence and trust are the benefits of excellent CSR.

As corporates grow in strength in a rapidly globalizing environment, their contribution to the development of the society becomes increasingly pertinent. The emergence of CSR has been critical for millions of people left below the poverty line.

Bharat Petroleum receives complete support and direction from board of directors for its CSR activities, with director (HR) at the helm of affairs. D M Reddy, executive director, states, "Corporate Social Responsibility is one of the prime focus areas of a corporation. The whole approach towards contributing to society is very scientific and well thought out. In all such endeavors, the benefits should trickle down to as many people as possible. A corporation should look forward to long term relation with the community whose life it touches. Through community development initiatives, corporations can strive to evolve community holistically in all spheres, viz. health, education, infrastructure, income generation, vocational guidance. Having contributed towards a society after assessing the needs, a corporate can ensure a proper feedback system to realize the impact of its contribution. Based on studies, it can review its approach and implement new strategies."

Social Service Activities Undertaken by BP

Infrastructure Development: Provision of tube wells, bore wells, dug wells for drinking water and irrigation, construction of multi-purpose community center to accommodate school (non-formal education), balwadi (primary education), health centre, community centre, construction of sanitation block to promote hygiene, provision of alternate sources of energy, solar energy-based street lights and lighting for village and community centre.

Education: Support-provision of uniforms, notebooks, stationery, teaching material, educational aids, sweater and food supplements, educational scholarships to children from the economically backward classes for pursuing their studies, till complete their education, aptitude testing and vocational guidance for higher secondary children through experienced psychologists.

Health Care: Regular health checkup for villagers by doctors, provision of free medicines for minor ailments, guidance on family welfare and general health care, free medical dispensaries, cataract surgery and intra-ocular lens treatment.

Skill Enhancement: Adult education, modern farming practices, training on income generation vocations etc.

Case 3: Infosys and Corporate Governance

Infosys has been a pioneer in benchmarking its corporate governance practices with the best in South Asia.

Board Composition: The current policy of Infosys is to have an appropriate mix of executive and independent directors to have independence of the board and to separate board functions of governance and management. Currently, there is a fifteen-member board with 7 executives or full-time directors and eight independent directors. There is a clear definition of responsibilities of the Chairman, CEO (Chief Executive Officer) and COO (Chief Operating Officer) as the members of board and they have to make periodic presentations in front of the board on their responsibilities, performances and targets.

Independent Directors: Infosys follows not only the clause 49 (50% independent directors) of the listing agreement of Indian stock exchange but also the more stricter NASDAQ listing rules and Sarbanes-Oxley Act, US while selecting its independent directors on its board.

Board Member Selection Procedure: The board is responsible for the selection of new director and it delegates the selection of the new members and the nomination committee. The nomination committee further makes recommendation to the board regarding induction of any new member. The board also regularly works with the Chairman, CEO and the COO to determine the plans of internal succession of these posts in case of any emergency.

Board Functions: The board meets to review the quarterly results, discuss issues related to the company's financial performance and the shareholders' interest. The independent directors are always kept up to date with the information regarding the company by the

board through separate meetings arranged at regular intervals. The board currently has 6 Committees namely:

- Compensation committee;
- Audit committee;
- Nomination committee;
- Investment committee;
- Share transfer committee; and
- Investor's grievance committee.

The compensation committee carries out formal evaluation of the employees. The COO and the CEO handle interaction of the board with the clients, employees, institutional investors, the government and the press. The risk management is handled by the board overall with the help of directions from the audit committee.

Case 4: Reliance Industries and Corporate Governance

Reliance is one of the pioneers in the country in implementing the best international practices of Corporate Governance.

The board of Directors at Reliance periodically reviews its composition for ensuring a strong element of independence and commitment. The Directors are elected by the shareholders. However the board plays an important role in the selection of candidates for shareholders' approval.

Roles and Responsibilities of Board and Management: The board's roles and responsibilities include establishing an effective mechanism for overseeing the affairs, keeping in view the company's size, complexity, geographical operations and corporate tradition and culture. The Reliance's framework is designed to:

- Enable the Board to provide strategic guidance for the management;
- Define the respective roles and responsibilities of senior executives to ensure accountability; and
- Ensure a balance of authority such that no single individual has unfettered powers.

To ensure the truthful and factual presentation of its financial position, the Company has put in place a strong internal audit process. The board has also constituted an audit committee, which is responsible to the external reporting, performance and objectivity of the internal audit function and independence of the external auditors.

To ensure long-term shareholder value creation and to promote shareholder participation in corporate affairs, Reliance has established and maintained communication strategies, including a policy for clarity in notices of meetings. Reliance also maintains its corporate website for convenient access by the shareholders to all the information about the company.

The company has adopted a remuneration policy that attracts and maintains talented and motivated executives so as to encourage enhanced performance of the company. The remuneration policy envisages a clear relationship between performance and remuneration, including the link between remuneration paid and the overall corporate performance.

Summary

Nowadays, Corporate Governance has become an important subject. It is common that the minority investors rarely attend the meetings where it is pretty clear as to who has the power to implement changes. In capital markets, large investment banks particularly, Foreign Institutional Investors perform the function of making a judgment about the company and its management. There is a strong incentive for corporate managements themselves to adopt transparent processes and good governance practices. They have sought to cultivate an image of being honest with their investors and of being concerned about shareholder value maximization. The situation is changing in India and the more progressive companies are voluntarily accepting tougher accounting standards and more independent directors than are mandated by law. They are also adopting more healthy governance practices.

5. 10 REVIEW QUESTIONS

1. Define corporate governance. Why is it assuming greater relevance now a days?
2. Explain the factors influencing corporate governance.
3. Why is social responsibility important for business?
4. List out the arguments for and against social responsibility.
5. What are the practical problems that confront social action programs? How do you overcome them?
6. What do you understand by ethics? Why is ethics important for business?
7. State and explain the sources of business ethics.
8. How is ethics managed in a business unit?
9. State the difficulties involved in ethical decision-making. Bring out the guidelines, which help in ethical decision-making.
10. Distinguish between the terms 'Corporate Social Responsibility' and 'Corporate Governance'.
11. What are the key dimensions of 'Corporate Social Responsibility'?
12. 'Corporate Governance' has become an important 'buzzword.' Discuss the reasons.
13. Explain the role of Board of Directors in an organization.
14. Elucidate the issues and impediments of social sector in India.
15. Discuss the rationale behind the implementation of Corporate Social Responsibility at Bank of India.
16. How do independent directors on the board help Infosys to formulate best business policies?
17. Discuss the link between Board of Directors and Corporate Governance practices in Reliance.

BUSINESS LAW PART - 1

Structure

6.1 Law of Contract (Indian Contract Act, 1872)

6.2 Consideration & Competence to Contract

6.3 Performance and Discharge of Contracts

6.4 Contract of Agency

6.5 Review Questions

6.1 LAW OF CONTRACT (INDIAN CONTRACT ACT, 1872)

Most of the business transactions are based on promises to be performed at a later date. These promises whether made by businessmen or by others create certain rights and obligations and if these rights and obligations are not enforceable, the business world would be paralyzed. It is with the enforcement of these promises that the law of contract is concerned. The contract Act does not lay down the list of obligations that would be enforceable by law but lays down the rules subject to which rights or duties created by the parties would be enforced. The parties to the contract can make whatever rules they want, if these rules are not inconsistent with the provisions of the Act, they would be enforced by courts of law.

Meaning: Sec.2 (h) “An agreement enforceable by law is a contract.” Therefore, a contract has two important elements, one is the agreement, and the other is the obligation which is enforceable by law.

Agreement: Agreement is the outcome of the consensus between the parties who enter into a contract, i.e., the promise made between them, represents concurrence of their minds. (Sec.13). These would not be an agreement if the parties do agree but not on the same thing in the same sense, i.e., consensus is not sufficient. There has to be consensus ad idem. Sec.2 (e) defines an agreement as “Every promise or every set of promises forming consideration for each other”. A proposal when accepted becomes a promise.

Example: A received Rs.10, 000 from B and promises to supply him 10 bags of rice after 10 days. It is a promise. It shall be a set of promises if A promises to supply 10 bags of rice after 10 days and B promises to pay him Rs.10, 000 after the rice is supplied. Thus,

Agreement = Offer + Acceptance.

Offer (Proposal): Offer [(proposal) (Sec. 2 (a))] “When one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of the other to such act or abstinence, he is said to make a proposal”.

Acceptance: Acceptance has been defined u/s (Sec.2 (b)) as “When the person to whom the proposal is made, signifies his assent thereto, the proposal is said to be accepted. A proposal when accepted becomes a promise”. Example: A lost his Cell Phone and announced that anybody who brought his cell phone back home would receive Rs.500 as reward. B heard the announcement and brought the Cell Phone back home. He is said to have accepted the proposal by doing the act required by A and hence he can recover the reward.

Promisor: A person who makes the promise is called the ‘Promisor’ or ‘Offeror’. And the person to whom the proposal is made is known as ‘Promisee’ or ‘Offeree’. In case an agreement is a set of promises, then a person becomes a promisor and promisee. Thus if there is an offer, acceptance and consensus ad idem between the parties, there is an agreement. However, this agreement does not become a contract unless there is a corresponding obligation, i .e, enforceability at law.

Obligation (Sec.10): It is the legal duty of a person to carry out what he has promised to do or not to do. All agreements are contracts if they are made by the free consent of the parties competent to enter into contract, for a lawful consideration and with a lawful object and not hereby expressly declared to be void. Therefore, a person becomes legally bound to do what he has promised to do only if the following conditions are fulfilled.

1. **Capacity of the Parties:** Only those persons who are competent to enter into a contract can create valid obligations. A minor, a lunatic, a drunkard etc. , suffer from flaw in capacity to Contract and therefore the contract made with them can’t be enforced against them.
2. **Free Consent:** Absence of consent does not create a legal obligation. For an agreement to become a contract the parties to an agreement should give their consent to the agreement out of their own free will. It should not be induced by coercion, undue influence, fraud, misrepresentation, etc.
3. **Lawful Consideration and Object:** Consideration means something in return, i.e. ‘quid pro-quo’.
Example: A promises to give his bike to B for no money, here, there is no consideration, hence no obligation. Without consideration a promise can’t be enforceable by law. However, consideration need not be in money or in kind. It may be of an act, abstinence, a promise to do, or not to do something. But consideration should be lawful.
Example: A promises to pay a sum of money to B if B smuggles the object proposed by A. In this case, there is no lawful object.
4. **Intention to create Legal Relationship:** Social obligation can’t bring legal relationship. For example: Father promised his son to pay Rs.100 per

day for pocket expenses, however later on did not pay the said amount. Therefore, if the parties do not intend to be bound by law at the time they make promises, nothing can bind them to their promises, later on.

5. **Possibility of Performance:** Example: A promised B that he would make The Sun raises in the West if B pays him Rs.1 lakh and B agree to it, this agreement does not create any legal obligation as it would not be enforceable by law.
6. **Meaning should be certain: Example:** A agrees to sell B's horse. There is nothing whatever to show which horse is intended. The agreement is void for uncertainty.
7. **Legal Formalities (If required):** An agreement to make a gift for natural love and affection should not only be in writing but registered also (Sec 25). In the absence of any such specific requirement an oral agreement is as enforceable as a written agreement.
8. **Agreements not Declared Void:** Indian Contract Act has specifically declared some agreements to be not enforceable at law e.g. Agreements in restraint of trade, Agreements in restraint of marriage, wagering agreements etc. Thus the law of Contract is not the whole law of Agreements. It is the law of those agreements which create obligations.

The Law of Contract is not the Whole Law of Obligations

There may be certain duties (obligations) which the law may enforce though they were not agreed to by the parties. Such obligations do not create a contract between them. These obligations may arise in the following ways:

1. **Torts and Civil Wrong:** Where a tort is committed by one person against another the former is bound to compensate the latter even though there is no agreement between the two.
2. **Judgments of Courts:** These obligations are imposed by the Court by their verdict.
3. **Quasi Contracts:** Where law creates and enforces an obligation between two persons, it is known as Quasi Contract.
4. **Status Obligation:** It is the duty of the husband to provide necessities of life to his wife, and if the husband fails to do so , the wife can enforce this obligation at the courts of law and can seek maintenance from her husband.

Kinds of Contracts

1. **Valid Contract:** It is an agreement which fulfils all the essentials of enforceability and can be enforced by either of the parties at the courts of law.
2. **Voidable Contract:** Sec 2(i) lays down that “ An agreement which is enforceable by law at the option of one or more of the parties thereto , but not at the option of the other or others , is a Voidable Contract.” This arises where the consent of one of the parties to the contract is not free.

Example: A, at the point of pistol makes B agree to sell his bicycle for Rs.500. Here B's consent is not free.

Circumstances in which a contract is voidable are:

(A) At the conception

- a) Consent caused by fraud (Sec. 14, 17 and 19)
- b) Consent caused by coercion (Sec . 14, 15 and 19)
- c) Consent caused by misrepresentation (Sec . 14, 18 and 19)
- d) Consent caused by undue influence (Sec . 14, 16 and 19A)
- e) When one party induces another to enter into an agreement the object of which is unlawful though it is not known to the other party.

(B) By Subsequent Default

- a) Where offer of performance is not accepted (Sec. 38)
- b) When one party prevents performance of reciprocal promise (Sec. 53)
- c) When a party fails to perform at the time fixed, if time is the essence of the contract (Sec. 55)

Consequences of Rescission of Voidable Contract:

When a voidable contract is rescinded?

- a) As regards the party at whose option the contract is voidable , if he has received any benefit from another party to such contract , he must restore such benefit so far as may be, to the person from whom it has been received. The benefit must have been received under the contract and not otherwise. Security for performance is not the benefit received under the contract.
- b) As regards the other party, he need not perform his promise.

3. **Void Contract:** [Sec 2(j)] "A contract which ceases to be enforceable by law becomes void when it ceases to be enforceable" e.g. A agrees to sell his car to B for Rs .10,000. All essentials of a contract are fulfilled. If A refuses to sell his car, B can go to the court and the court would enforce A's promise. But if, before the delivery the car is destroyed by Tsunami, the court cannot enforce anything and hence this contract becomes unenforceable i.e. void. Thus, void contract is one which was a valid contract when it was made but becomes void later on. Those agreements which are void **ab initio** (from the very beginning) are called Void Agreements and those which become void later on are called Void Contracts.

Following circumstances will transform a valid contract into a void contract.

- a) **Contingent contract:** A contingent contract to do or not to do something on the happening of an uncertain future event becomes void, when the event becomes impossible (Sec 32).
- b) **Repudiation of a voidable contract:** When a voidable contract is rescinded by the party at whose option it is voidable, the contract becomes void.
- c) **Subsequent impossibility (Sec. 56):** A contract which becomes impossible to perform, after it is made, becomes void.
- d) **Subsequent illegality (Sec. 56):** A contract becomes void if it becomes illegal after it is made.

Consequences of a Void Contract: Sec. 65 lays down that when a contract becomes void, the party who has received any advantage under such agreement should restore it or make compensation for it to the party from whom he received it.

4. Void Agreement: An agreement not enforceable by law is called a void agreement. If any of the essentials of obligations (enforceability) , other than free consent , is missing the agreement cannot be enforced at Courts of Law.

Invalidating Causes:

In the following circumstances an agreement is **void ab initio**.

- a) If a party to the contract is incompetent to contract (Sec . 10 , 11 & 12)
- b) If the agreement is without consideration (Sec.10, 25) barring certain exceptions.
- c) If the consideration or object is unlawful (Sec. 23)
- d) If the meaning of the contract is uncertain (Sec. 29)
- e) If the agreement is to do an impossible act (Sec. 56)
- f) If both the parties enter into an agreement under a mistake as to the essential matter of fact (Sec. 20). There is no **consensus ad idem**.
- g) If both the parties are under a mistake as to foreign law (Sec. 21)
- h) If the agreement is in restraint of marriage of a person other than a minor (Sec. 26)
- i) If the agreement is in restraint of trade (Sec. 27) Barring certain exceptions.
- j) If the agreements is in restraint of legal proceedings (Sec . 28)
- k) If the agreement is by way of wager (Sec. 30).

5. Illegal Agreement: An illegal agreement is one which is forbidden by law i.e. it is entered into with the intention of violating the law Example:A agrees to steal furniture for B for a consideration of Rs. 1, 00, 000. It is illegal and therefore it is void. It also attracts the penal provisions

of the law it is violating

While all illegal agreements are void, all void agreements are not illegal. Parties to an illegal agreement cannot get any help or protection from law courts.

6. **Unlawful Agreements:** (Sec. 23). In simple words an agreement may be unlawful because it is:
 - a) Immoral i .e. contrary to sound and positive morality as recognized by law, e.g. cohabitation.
 - b) Opposed Public Policy -i.e. contrary to the welfare of the State as tending to interfere with the civil or judicial administration, or with individual liberty of citizens, e .g. bribing a public servant.
 - c) Illegal i .e. contrary to positive law, being forbidden either by statutes law or common law; Hence a line of demarcation needs to be drawn between illegal and unlawful agreements.
7. **Unenforceable Contract:** Contracts which have all the essentials of enforceability but cannot be enforced due to certain technicalities like insufficiency of stamp, etc. are termed as unenforceable contracts.
8. **Express Contract:** It is one where the intentions of parties are stated in words either written or spoken. Example: A goes to B's shop and asks him to supply 10 boxes @ Rs.20per box. B tells him that he is ready to supply the boxes at the mentioned rate. This is an Express Contract. The same intention of the parties may be expressed in writing signed by both the parties.
9. **Implied Contract:** The evidence of an implied contract is to be deduced from the acts or conduct of the parties. No exchange of words either written or spoken takes place, but the manifestation of their intentions is inferred from their respective acts or conduct.
10. **Quasi Contracts:** These are those obligations which are imposed by the Contract Act and do not arise from a consensus between the parties. Example: A, a tradesman, leaves goods at B's house by mistake. B treats the goods as his own. B is bound to pay A for them; the obligation is imposed by law.
11. **An Executed Contract:** It is one where both the parties to a contract have discharged their respective responsibilities by performing them. All transactions of Cash sales are the examples of Executed Contracts.
12. **An Executory Contract:** It is one where one or both the parties are yet to perform their respective promises. It is partly Executed and partly Executory.
13. **Unilateral Contract:** It is one where at the time when the contract is made one party has already performed his obligation and the obligation on the part of the other party only, is outstanding. Example: A goes to a bus stand ticket-counter and buys a ticket for journey. A has performed his duty under the contract i. e. to pay the scheduled fare. But the bus authority is yet to perform his promise i. e. of carrying him from one point to another. This is a Unilateral Contract.

14. Bilateral Contract: As against Unilateral Contract, a Bilateral Contract is one where at the time of entering into the contract both the parties to the contract are yet to perform their respective

Offer and Acceptance

As seen earlier the first step in making a contract starts with making an offer. We shall, therefore, discuss as to what constitutes a 'lawful offer'.

Offer or Proposal

'Offer' and 'Proposal' are synonymous terms. According to sec. 2(a), "when one person signifies to another his willingness to do or to abstain from doing anything with a view to obtaining the assent of that other to such act or abstinence, he is said to make a proposal". The person making the proposal is called the "Promisor" and the person to whom the offer is made is called the "Promisee" [Sec.2 (c)] Example: A offers to pay Rs.100 to B if B washes his cloths. A is the promisor and B is the promisee for the promise to pay Rs.100. A is the promisee and B is the promisor for washing his clothes. It is important to note that the offer must be made with the object of obtaining the assent of the other party.

Rules Regarding a Lawful Offer

A valid offer must be in conformity with the following rules:

1. Terms of an offer should be definite or should be capable of being made definite.
2. Offer should be made with an intention to create legal relationship: In the absence of such intention no obligation can arise. Absence of such intention may be express or implied. Example: Where A proposes to sell his 'Television' to B for Rs. 10000 but tells him that the breach of promise by either party would not create legal rights, no binding contract would arise in that case even if the agreement is in writing.
3. **There is no valid offer where:**

a) **It is a mere statement of intention :**

Example: A gives an advertisement in the television that he would dispose of his building by auction on 5th June at 8 a .m. in the lawns of his bungalow. B, who saw this advertisement, travels a distance of 200 kilometers and reaches A's bungalow at the given time and date and finds that auction has been cancelled. A cannot be held liable because his advertisement to hold auction did not constitute an offer; it was merely an intention to hold an auction where bids would be received.

- b) **It is an invitation to offer:** Where A puts his building to public auction he is inviting offers from the bidders and he accepts the offer by falling of the hammer or by any other customary method. The actual offer is the bid made at the auction and the auctioneer accepts it.
4. Offer must be communicated: The offer must be brought to the knowledge of the person to whom it is made. If an offer is not communicated to the offeree, the latter cannot accept it.
 5. Offer should not contain a term the non-compliance of which would amount to acceptance. Example: A writes to B "I shall buy your furniture for Rs, 10,000, if you do not reply I shall assume that you have accepted my offer. This is not a valid offer.
 6. Offer may be express or implied: An offer is express when it is stated in words, written or spoken.
 7. An offer may be general or specific: When an offer is made to a specific person it is called a specific offer and it can be accepted only by that person but when an offer is addressed to an uncertain body of individuals i.e. the world at large, it is a general offer and can be accepted by any member of the general public by fulfilling the condition laid down in the offer.

Lapse of an Offer:

An offer once made cannot be continued for ever. Liability of the party making the proposal cannot be continued for all times to come. An offer becomes invalid i.e. comes to an end in the following circumstances.

- a) When the stipulated or reasonable time has expired: Example: A offers to sell his Modern table to B for Rs. 5000 and tells him that B must communicate his acceptance within three days. On fourth day B brings Rs.5000 to buy the table. A refuses. A is not bound because the offer has lapsed on the third day.
- b) Where the offer becomes illegal after it is made: Example: X of Mumbai offers to buy Peanuts from Y of Chennai. Next day Central Government prohibits inter-state transfer of Peanuts. The offer lapses by subsequent illegality.
- c) Where the offerer or offeree dies or becomes insane before the offer is accepted: Example: A offers to sell his cow to B. Before B could accept the offer, A dies. B cannot accept the offer.
- d) Where the offeree does not accept the offer in the mode the offerer had prescribed: Example: A writes to B that he wants to sell his furniture to B for Rs.10, 000. He also writes to B that if B wants to buy the furniture, he (B) should send him (A) a telegram accepting the offer. B writes a letter to A accepting the offer. If A keeps silence over it this is a valid acceptance. But if A informs B that he is not treating this letter as acceptance because the offer has not been accepted by a telegram, then this letter would not result in

- acceptance.
- e) An offer lapses by counter offer by the offeree: Example: A tells B. “I want to buy your land for Rs. 10,000”. B says, “I shall sell my land for Rs .15, 000.” A refuses to buy it for Rs. 15,000. Then B insists that A should buy it for Rs. 10,000. A refuses to do so. A is not bound by his offer because the statement of B that ‘I shall sell my land for Rs. 15, 000’ is not acceptance of A’s offer but a counter offer. When a counter offer is made the original offer lapses and there is nothing for the offeree to accept. But an enquiry should not be mistaken for a counter offer.
 - f) An offer comes to an end when the offerer revokes his offer before it is accepted.

Tender (Standing Offer):

A tender is an offer made in response to an invitation to offer. The party inviting tenders may require a definite quantity of goods or services to be supplied, in that event the person who responds to that invitation is said to have made a definite offer and would become bound by it if it is accepted.

Acceptance: “When the person to whom the proposal is made signifies his assent thereto the proposal is said to be accepted A proposal once accepted becomes a contract.” Where two parties make offers to each other with identical terms without knowing each other’s offer. These offers are called ‘CROSS OFFERS’.

Who can accept? Where an offer is made to a specified person, only that specified person can accept it and nobody else. But where the offer is made to an uncertain body of persons, anybody can accept the offer.

Rules Regarding Acceptance

- a) Acceptance must be absolute and unqualified: The offeree must accept unconditionally all the terms of the offer without any change in any of them.
- b) The Acceptance must be expressed in some usual and reasonable manner, unless the proposal prescribes a manner in which it is to be accepted
- c) Acceptance by performing Conditions or receiving Consideration: Example: A offers to pay Rs. 100 to B if B throws the ring ball into the basket in first attempt. B immediately throws the ball into the basket in first attempt. By the performance of this condition B is said to have accepted the offer.”
- d) Acceptance must be communicated: Unless acceptance is communicated it would not turn the offer into a contract. However, if the offeree posts the acceptance but it does not reach the offerer, it would be deemed to be communicated. But the offerer cannot frame his offer in such a way that the silence of the offeree would become his acceptance.

- e) Acceptance should be given within stipulated time and before the offer is revoked: If the offer lapses before acceptance is given the acceptance would not result into a contract. But where no time limit is stipulated the offer should be accepted within a reasonable time.
- f) Where an offeree accepts an offer knowing that it has been made by the offeror under a mistake, the contract is not binding upon the offeror.

Consensus Ad Idem

According to sec. 13, “Two or more persons are said to consent when they agree upon the same thing in the same sense”. But where the circumstances lead one party to believe that the other would have understood the terms of the agreement, law may imply unenforceable agreement. Because it is not what a party thinks in his mind but what he expresses or does that binds him to the contract.

Communication of Offer and Acceptance

Problem of communication arises when the parties to the contract are not face to face with each other. It arises in the following cases:

- Contracts through Telephones
- Contracts through Post

Offer and acceptance are generally made through letters and telegrams. Advertisements, notices, circulars, etc., are also used to make an offer. The rules of communication regarding them are as follows:

(1) “The communication of a proposal is complete when it comes to the knowledge of the person to whom it is made...” (sec. 4)

(2) “....The communication of an acceptance is complete –

- As against the proposer, when it is put in a course of transmission to him, so as to be out of the power of acceptor; and
- As against the acceptor, when it comes to the knowledge of the proposer...” (Sec.4)

From the above it is clear that an offer may be revoked at any time before the acceptance is put in course of transmission to the proposer.

Revocation of Proposal and Acceptance

“A proposal may be revoked at any time before that communication of its acceptance is complete as against the proposer, but not afterwards.”

Communication of Revocation

“The communication of a revocation is complete... As against the person who makes it, when it is put into a course of transmission to the person to whom it is made, so as to be out of the power of the person who makes it as against the person to whom it is made, when it comes to his knowledge.”

Agreement to Agree in Future

Agreement to enter into an agreement upon terms to be settled afterwards between the parties is a contradiction in terms. It is absurd to say that a man enters into an agreement till the terms of agreement are settled; until those terms are settled, he is perfectly at liberty to retire from the bargain”.

6.2 CONSIDERATION AND COMPETENCE TO CONTRACT

Consideration is one of the elements of obligation. An agreement becomes enforceable only if it is supported by consideration. (Sec. 10)

“All agreements are contracts if they are made... for a lawful consideration...” It clearly shows that consideration is an important prerequisite of a valid contract. (Sec.25) “An agreement made without consideration is void...” Hence the rule is: No Consideration, No Contract.”

Essentials of Consideration

(A) Based on Definition

An analysis of the above definition reveals the following essentials of consideration.

(1) Consideration must move at the desire of the promisor

(2) It may move from promisee or from any other person on behalf of promisee.

Stranger to Contract

It is a general rule that a person, who is not a party to a contract, cannot sue on the contract even though the contract is for his benefit i.e. unless there is privity of contract, the relationship is not enforceable.

(3) Consideration may be past, present or future

(4) Consideration must be real and not illusory

(5) Consideration may consist of an act, abstinence or promise

(B) Based on Other Provisions

In addition to the above essentials of consideration that emerge from the definition, the others are as follows:

(1) Consideration must be lawful: (Sec. 10) “All agreements are contracts if they are made for a lawful consideration” The consideration of an agreement is unlawful, if (i) it is forbidden by law, or (ii) it is of such a nature that, if permitted, it would defeat the provisions of any law, or (iii) it is fraudulent or (iv) it involves or implies injury to the person or property of another or (v) the court regards it as immoral or opposed to public policy (Sec. 23).

(2) Consideration need not be adequate to the value of the promise: (Sec. 25) “An agreement to which the consent of the promisor is freely given is not void merely because the consideration is inadequate, but the inadequacy of the consideration may be taken into account by the Court in determining the question whether the consent of the promisor was freely given.”

Exceptions to the Rule of Consideration (Sec. 25): In the following cases the agreement would be enforceable even though they are made without consideration.

1. Love and affection:

An agreement without consideration is enforceable if

- (a) It is made out of love and affection;
- (b) The love and affection is natural because the parties are so related to each other;
- (c) The agreement is in writing;
- (d) The agreement is registered under law.

2. **Compensation for voluntary services:** “If it is a promise to compensate, wholly or in part, a person who has already voluntarily done something for the promisor, or something which the promisor was legally compellable to do.”

3. **Promise to pay a time barred debt:** If it is a promise, made in writing and signed by the debtor or his agent to pay wholly or in part a debt which is barred by the limitation.

4. **Contract of Agency:** Sec. 185 provides “No consideration is necessary to create an agency.”

5. **Gift already made:** (Sec. 25) “Nothing in this Section shall affect the validity, as between the donor and donee, of any gift actually made.”

Unlawful Agreements

According to the Indian Contract Act (Sec. 23), “The consideration or object of an agreement is lawful, unless it is forbidden by law; or is of such a nature that, if permitted, it would defeat the provisions of any law; or is fraudulent; or involves or implies injury to the person or property of another; or the court regards it as immoral, or opposed to public policy. Let us see the provisions of Sec. 23 which make an agreement unlawful.

- 1. **Forbidden by law:** If the object of the agreement or the consideration of the agreement is the doing of an act which is forbidden by law, the agreement is void.

2. **If it is of such a nature that, if permitted, it would defeat the provisions of any law:** i.e. it would indirectly lead to a violation of the law.
3. **If it is fraudulent:** Any agreement whose object is to defraud others is void.
4. **If it involves or implies injury to the person or property of another**
5. **If the Court regards it as immoral**
6. **If the Court regards it as opposed to public policy:** The following agreements have been held to be against public policy:
 - (a) **Trading with Enemy:**
 - (b) **Agreements for stifling prosecution:** An agreement to suppress criminal charge is void because if a person has committed a crime, public policy requires that he should be prosecuted.
 - (c) **Agreements interfering with the Course of Justice:** An agreement entered into with the object of exercising improper influence on judges or officers of justice is bad in law as opposed to public policy.
 - (d) **Agreements tending to an abuse of legal process:** There may be two types of agreements under this head, one is Maintenance and the other is Champerty.
 - (e) **Agreement to vary the period of limitation:** An agreement that reduces or increases the period of limitation as laid down by the law of limitation is opposed to public policy.
 - (f) **Traffic in Public Offices:** An agreement whereby an appointment to a public office is procured for monetary consideration is against public policy because it would cause corruption in administration of the State.
 - (g) **Agreement creating an interest opposed to duty**
 - (h) **Agreements restraining personal freedom**
 - (i) **Agreements opposed to parental rights and duties:** Father is supposed to be the guardian of his children and in the absence of the father their mother acquires this right as well as responsibility and this right cannot be bartered away.
 - (j) **Marriage Brokerage Agreements:** Agreement to pay reward to a person for negotiating marriage is opposed to public policy.
The following agreements are also opposed to public policy.
 - (i) Agreements in restraint of marriage.
 - (ii) Agreements in restraint of trade.
 - (iii) Agreements in restraint of legal proceedings.

Competence to Contract

Competence to contract is one of the essential elements of enforceability of an agreement. According to Sec. 10 'All agreements are contracts if they are made by... the parties competent to Contract.....As regards the meaning of competence, Sec.11 of the Contract Act states that "Every person is competent to contract who is of the age of majority according to the law to which he is subject, and who is of sound mind, and is not disqualified from contracting by any law to which he is subject. The following persons are incapable of entering into a contract:

1. A person who has not attained the age of majority i.e. a person who is still a **Minor**.
2. A Person who is not of sound mind i.e. a person of **unsound mind**.
3. A Person who is **disqualified by any other law** to which he is subject (i.e., other disqualifications.)

Minor

A minor is a person who has not completed 18 years of age on the date of the contract. But in the following two cases the minority would continue up to the completion of 21 years of age:

- (a) Where a guardian to the person or property of a minor is appointed by the court.
- (b) When the minor is under the guardianship of the court of Wards, i.e. minor's property is looked after by the Court of Wards.

Rules Relating to an Agreement with a Minor

- (1) **Agreement is void ab initio:** According to Sec. 10, an agreement made by a person incompetent to contract is void. Hence an agreement made by a minor is void. The agreement is *void ab initio* i.e. void from the very beginning. However, Sec. 68 of the Contract Act lays down "if a person, incapable of entering into a contract or any one whom he is legally bound to support, is supplied by another person with necessaries suited to his condition in life, the person who has furnished such supplies is entitled to be reimbursed from the property of such incapable person.
- (2) **Minor can be a promisee:** An agreement is void as against a minor but a minor can derive benefit under a contract. The privilege of minority is available to the minor only. Other person cannot avoid the contract because the promisee is a minor. Thus the minor can enforce the agreement against the other party.
- (3) **A Minor's Agreement cannot be ratified:** Since an agreement with a minor is void ab initio, i.e. it does not exist in the eyes of law, it cannot be ratified by a minor after completing the age of majority.
- (4) **No Compensation is payable by a minor:** Though an agreement with a minor is void, the minor would not be called upon to refund any benefit which he has received, under such an agreement (i.e. Sec. 64 and Sec. 65 would not apply to a minor).
- (5) **The rule of estoppels does not apply to a minor** i.e. a minor can misrepresent his age and enter into an agreement and can still plead infancy to avoid that agreement.
- (6) **No recovering back the money paid:** Where an infant has paid money under a void or voidable contract he cannot recover it unless there has been a total failure of consideration.
- (7) **A minor can be sued:** If what the infant has done lies right outside the terms of the contract, the infant can be made liable.
- (8) **Agency.** A minor acting as an agent cannot be held liable even for those acts for which other agents would incur personal liability.

- (9) **Negotiable Instrument:** A minor can also make and deliver negotiable instruments and can negotiate them making all other persons except him liable on them.
- (10) **Partnership:** An agreement with a minor is void. But a minor can be admitted into the benefits of partnership with the consent of all the partners (Partnership Act). This means that the losses of the firm can be recovered only from his share in the firm but unlike other partners his personal property would not be liable for firm's losses.
- (11) **Insolvency:** A minor cannot be adjudicated insolvent.
- (12) **Joint Agreement:** Where a minor and another person make a joint promise, the promisee cannot enforce the agreement against the minor but he can enforce it against the other person.
- (13) **Guardianship:** Though an agreement made by a minor is void but an agreement made by the guardian of a minor is binding on the minor if it is for the benefit of the minor.
- (14) **Minor's Parents:** Agreements made by a minor are not enforceable against his parents; even through they are for the necessities supplied to the minor.

Persons of Unsound Mind

According to *Sec. 11* only a person of sound mind can make a contract. *Sec. 12* further defines the term sound mind in these words, "A person is said to be of sound mind for the purpose of making a contract if, at the time when he makes it, he is capable of understanding it and of forming a rational judgment as to its effect upon his interest..." Thus two essentials of '**Sound Mind**' emerge from this definition: **Capacity to understand: and Capacity to make a rational judgment.**

There must be free and full consent of the parties so as to bind them to the contract. Consent is an act of reason accompanied by deliberations. It is due to the absence of rational and deliberate consent that conveyance and contracts of persons of unsound mind are deemed to be invalid.

A person of unsound mind may be divided into two broad categories:

Idiots: An Idiot is one who has lost mental powers completely, *i.e.*, his brain has not developed enough to enable him, at all to understand the contract or of forming a rational judgment of its effects upon his interest. Hence an agreement with him is always void. However, he can be sued for necessities of life supplied to him or to anybody dependent upon him.

Lunatic: Lunacy arises from the illness of the brain or mental or bodies distress. The essential element of lunacy is that the mental powers of the lunatic are so deranged that he cannot make a rational judgment of any subject the period of lunacy.

Effects of Agreements Made by Persons of Unsound Mind

An agreement made with a person who is suffering from lunacy at the time of entering into the contract, is void (*Sec. 10*).

Other Disqualifications

- **Alien Enemy:** A citizen of a foreign country is known as an alien.
- **Foreign sovereigns and their Ambassadors.** Foreign sovereigns and their Ambassadors in India can enter into contracts with Indian citizens and can sue them in Indian courts but no suit can be filed against them in local courts unless the permission of the Central Government to this effect has been obtained.
- **Corporation:** A corporation is an artificial person created by law. Being a legal person only, it cannot act by itself. It has to act through some agent. Its contractual capacity suffers from the
 - Natural Limitation; (b) Legal Limitation.
- **Insolvents:** When a person is adjudged insolvent, he loses contractual powers over his property.
- **Convicts:** A person against whom a sentence of imprisonment is passed loses the capacity to contract.
- **Married women:** A married woman used to suffer from certain disabilities with regard to making of contracts under English Law before 1935. A woman, married or single, in Indian Law, is under no disability as regard, entering into contracts with regard to the property that belongs to her (e.g. stree dhan of a married women). Her contracts can be enforced against her husband's property if he has failed to provide necessaries of life to her and the contract relates to necessaries of life.

Free Consent

The term free consent consists of two requirements viz.:

- There should be consent; and
- Consent should be free.

Consent: The term consent is defined by Sec. 13 as “Two or more persons are said to consent when they agree upon the same thing in the same sense”

Free Consent: “Consent is said to be free when it is not caused by:

1. Coercion, as defined in section 15, or:
2. Undue influence as defined in section 16, or:
3. Fraud, as defined in section 17, or:
4. Misrepresentation, as defined in section 18, or:
5. Mistake subject to the provisions of sections 20, 21 and 22. Consent is said to be so caused when it would not have been given but for the existence of such coercion, undue influence, fraud, misrepresentation or mistake.” (Sec.14)

Coercion

“**Coercion** is the committing or threatening to commit any act, forbidden by the Indian Penal Code or the unlawful detaining or threatening to detain any property, to the

prejudice of any person whatever, with the intention of causing any person to enter into agreement.”(Sec.15)

- Coercion is **committing any act** forbidden by the Indian Penal Code with the intention of causing any person to enter into an agreement.
- Coercion is the **threatening to commit any act** forbidden by the Indian Penal Code, with the intention of causing any person to enter into an agreement.
- Coercion is the **Unlawful detaining** of any property to the prejudice or any person, whatever, with the intention of causing any person to enter into an agreement.
- Coercion is the **threatening to detain**, unlawfully, any property, to the prejudice of any person whatever, with the intention of causing any person to enter into an agreement.

Effect of Coercion: Sec, 19 states “When consent to an agreement is caused by coercion... the agreement is a contract voidable at the option of the party whose consent was so caused” i.e. the aggrieved party at its option, may set aside the contract or may insist that the contract shall performed. Sec. 72 further states, “A person to whom money has been paid, or anything delivered... under coercion, must repay or return it.”

Undue Influence

[Sec. 16 (1)] “A Contract is said to be induced by ‘undue influence’ where the relations subsisting between the parties are such that one of the parties is in a position to dominate the will of the other and uses that position to obtain an unfair advantage over the other.” Three conditions should be fulfilled:

1. The relation between the contracting parties should be such that one party is in a position to dominate the will of the other; and
2. Such party has used that dominant position to enter into a contract with the latter; and
3. Such party has obtained an unfair advantage over the other.

Effect of Undue Influence: [Sec. 19 (A)] “When consent to an agreement is caused by undue influence the agreement is a contract voidable at the option of the party whose consent was so caused.

Pardanashin Women: A pardanashin woman is susceptible to undue influence and therefore, the law throws around her a “Special cloak of protection” i.e. where such a woman signs a sale, mortgage, gift or release, the person obtaining her signatures has to prove that the transaction was not only explained to her but also that she had understood the transaction and that no undue influence was exercised on her.

Difference between Coercion and Undue Influence

- Type of pressure: Physical or crude force; Mental pressure.
- Burden of Proof: Prove how the coercion was exercised; Prove that the other party was in a position to dominate his will and that the transaction is unconscionable.
- Nature of Transaction: The party uses that position to obtain an unfair advantage over the other; A transaction, though fair but induced by coercion can still be avoided.

Fraud

Fraud means and includes any of the following acts committed by a party to a contract, or with his connivance or by his agent with intent to deceive another party thereto or his agent or to induce him to enter into the contract:

- a) The suggestion, as a fact, of that which is not true by one who does not believe it to be true;
- b) The active concealment of a fact by one, having knowledge and belief of the fact;
- c) A promise made without any intention of performing it;
- d) Any other act fitted to deceive;
- e) Any such act or omission as the law specially declares to be fraudulent (Sec. 17)

Can silence be Fraudulent? (Sec. 17) “Silence as to facts likely to affect the willingness of a person to enter into a contract is not fraud unless the circumstances of the case are such that regard being had to them it is the duty of the person keeping silence to speak or unless his silence is in itself equivalent to speech.”

Exception: Silence would amount to Fraud if

- a) It is the duty of the person keeping silence to speak. These are called **uberrimae fidei** contracts;
- b) His silence is, in itself, equivalent to speech:

Effect of Fraud

- a) Where Fraud is the cause of the contract: (i) Voidable Contract : (ii) Damages
- b) Where Fraud is not the cause of contract: An attempt at deceit, which does not deceive, is no fraud.

Misrepresentation

Misrepresentation, better known as ‘Innocent misrepresentation’ has been defined by Sec. 18 as: “Misrepresentation means and includes-

- a) The positive assertion in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true;

- b) Any breach of duty which, without an intent to deceive, gains an advantage to the person committing it, or any one claiming under him, by misleading another to his prejudice or to the prejudice of any one claiming under him;
- c) Causing, however innocently, a party to an agreement to make a mistake as to the substance of the thing which is the subject of the agreement”.

Effect of Misrepresentation

“When consent to an agreement is caused by... misrepresentation, the agreement is a contract voidable at the option of the party whose consent is so caused”.

Distinction between Fraud and Misrepresentation

Fraud: Intention to deceive there is no intention to deceive, fraud to recover damages not available in case of misrepresentation.

Misrepresentation: the aggrieved party loses the right to rescind the contract if it could discover the truth with ordinary diligence. In Fraud, this exception does not apply.

Mistake

Salmond has described these contracts as “error in Causa”. As “error in consensus” i.e. there is no ‘consensus ad idem’; because of some misunderstanding, called ‘**Mistake**’, parties do not agree upon the same thing in the same sense. According to Indian Contract Act, Mistake is of two types, (1) Mistake as to law and (2) Mistake as to fact.

Mistake of Law (Sec. 21):

“A contract is not voidable because it was caused by a mistake as to any law in force in India, but a mistake as to a law not in force in India has the same effect as mistake of fact.” The reason of this rule lies in the legal maxim “Ignorance of law is no excuse”.

Mistake of Fact: (Sec 20 :) “Where both the parties to an agreement are under a mistake as to a matter of fact, essential to the agreement, the agreement is void”.

Essentials:

- (1) Mistake must be mutual;
- (2) Mistake must relate to a fact;
- (3) Fact should be essential:

Type of Mistakes: Mistake of fact can be divided into the following categories:

(A) Bilateral Mistakes:

a) **Mistake as to the subject Matter:**

- (i) Mistake regarding existence of subject matter:
- (ii) Mistake regarding identity of the subject matter i.e. the two parties understand different things to be the subject matter:
- (iii) Mistake regarding quantity of subject matter:

- (iv) Mistake regarding title of the subject matter: Where both the parties believe that the seller has the right to sell the goods but unknown to both, the seller has no title to the goods
- (v) Mistake regarding the price of the subject matter.
- (vi) Mistake regarding the quality of the subject matter.

b) **Mistake as to the possibility of performance of the agreement:** if both the parties to the agreement believe that the agreement is capable of being performed though it is not, the agreement is void.

(B) Unilateral Mistake: In the following circumstances, even unilateral mistake will make the contract voidable.

- a) **Mistake as to the nature of transaction:** This is an exception to the rule that mistake must be mutual. When one of the parties to a contract, without any fault of his own, is made to commit a mistake as to the nature of transaction the agreement would be void
- b) **Mistake as to the person contracted with:** When the identity of the person is essential to the contract and a mistake is committed regarding that, the contract can be avoided.

Void Agreements

Following are those contracts, which may not lack any of the essentials, discussed so far, still the law has specifically declared them void, they are:

(1) Agreement in Restraint of Marriage

(2) Agreement in Restraint of Trade

Following agreements are not in Restraint of Trade

- (1) Restraint during the term of service
- (2) Agreements which promote business and do not restrain it
- (3) Trade Combinations

(3) Agreement in Restraint of Legal Proceedings (Sec. 28) “Every agreement, by which any party thereto is restricted absolutely from enforcing his rights under or in respect of any contract by the usual legal proceedings in the ordinary tribunals, or which limits the time within which he may thus enforce his rights, is void to that extent”.

Exceptions-Arbitration Agreements: An agreement to refer all future as well as present disputes in connection with a contract, to arbitration is valid.

(1) **Uncertain Agreements:** (Sec. 29) “Agreements the meaning of which is not certain or capable of being made certain, are void.”

(2) **Agreement by Way of Wager:** (Sec. 30) “Agreements by way of wager are void, and no suit shall be brought for recovering anything alleged to be won on any wager, or entrusted to any person to abide by the result of any game or other uncertain event on which any wager is made.

Agreements Collateral to Wagering Agreements

However transactions collateral or incidental to a wagering agreement are not void as per Sec. 30.

Lotteries: A lottery is a game of chance and is a wagering agreement.

Cross-word Puzzles: Cross-word puzzles are of two types:

- (i) One in which any person solving the puzzle would be awarded; therefore it is a game of skill and not of chance and is not a wagering agreement.
- (ii) The other type of cross-word puzzle is one in which the prize would be awarded to that competitor whose solution corresponds to the solution kept with the editor of the newspaper.

Contingent Contracts (Selection 31):

“A contingent contract is a contract to do or not to do something, if some event, collateral to such contract does or does not happen”. Thus it is a contract, the performance of which is dependent upon, the happening or non-happening of an uncertain event, collateral to such contract.

Example: X contracts to pay Y Rs.30, 000, in consideration of Y paying Rs. 100 monthly premium, if Y’s factory is burnt. This is a contingent contract.

Example: A agrees to pay B a sum of money if B marries C. Contracts of insurance and contracts of indemnity and guarantee are popular instances of contingent contracts.

Rules Relating to Contingent Contracts

1. Contingent on the act of party to the contract: If the performance of the promise is contingent upon the pleasure and will of the promisor it is not a contract at all.
2. Contingent upon the act of a third party: where the performance of a contract is conditional upon the act of a third party it is a valid contract.
3. Contingent on the happening of an event: (Sec.32) “Contingent contracts to do or not to do anything if an uncertain future event happens cannot be enforced by law unless and until that event has happened”.
4. Contracts contingent on the non-happening of an event (Sec.33): “Contingent contracts to do or not to do anything if an uncertain future event does not happen, can be enforced when the happening of that event becomes impossible, and not before”.
5. Contracts contingent on the happening or not happening of a specified event within fixed time (Sec.35): “Contingent contracts to do or not to do anything if a specified uncertain event happens within a fixed time, becomes void if at the expiration of the time fixed, such event has not happened or if, before the time fixed, such event becomes impossible”.
6. Contracts contingent on impossible event: (Sec. 36-)“Contingent agreement to do or not to do anything if an impossible event happens, are void, whether the impossibility is known or not to the parties to the agreement at the time when it is made.”

Difference between a Contingent Contract and Wagering Agreement

The main points of distinction between the two are as under:

1. A contingent contract is a valid contract but wagering agreement is absolutely void.

2. Parties have real interest in the occurrence but or non-occurrence of the event e.g., insurable interest in the property insured. Parties are not interested in the occurrence of the event except for the winning or losing the bet amount.
3. Future uncertain event is merely collateral: uncertain event is the sole determining factor of the agreement.

Quasi Contracts

A quasi contract is an obligation or a right created by law. A quasi contract is based on the principle that no person can enrich himself unjustly, at the expense of another. If he obtains a benefit which under the circumstances he ought, equitably to pay for it, the law would compel him to make the payment even though there is no contract requiring payment.

Following relations created by law resemble those created by contract:

1. **Necessaries Supplied to a Person Incapable Of Contracting:** Example: X supplies Y, a lunatic, with necessaries suitable to his conditions in life. X is entitled to be reimbursed from Y's property.
2. **Payment Of Money Due By Another:** (Sec.69) "A person who is interested in the payment of money which another is bound by law to pay, and who therefore pays it, is entitled to be reimbursed by the other."
3. **Non-Gratuitous Act for Another's Benefit:** (Sec.70) "Where a person lawfully does anything for another person or delivers anything to him not to do so gratuitously and such other person enjoys the benefits thereof the latter is bound to make compensation to the former in respect of or to restore the thing so due or delivered". *Example:* A Businessman leaves goods at B's house with the intention of persuading B to buy them. B treats the goods as his own. He is bound to pay A, for them.
4. **Finder Of Lost Goods:** (Sec. 71) "A person who finds goods belonging to another and takes them into his custody is subject to the same responsibility as a bailee."
5. **Money Paid By Mistake Or Under Coercion:** (Sec.72) "A person to whom money has been paid or anything delivered by mistake or under coercion must repay or return it". *Example:* X and Y jointly owe Rs. 1000 to Z. X alone pays the amount to Z and Y, not knowing the fact pays Rs.1000 over again to Z. Z is bound to repay the amount to Y.
6. **Suit upon Quantum Meruit:** The phrase 'Quantum Meruit' means as much as earned or 'in proportion to the work done'. This is a general rule, usually invoked where there is no agreement to pay for the work done.(Sec. 70)

6.3 PERFORMANCE AND DISCHARGE OF CONTRACTS

'Performance of Contracts' refers to the fulfillment of their respective legal obligations, created under the contract, by both the parties. It is a natural and normal mode of discharging a contract. The various aspects relating to performance are discussed below:

(A) Actual Performance

“The parties to a contract must either perform, or offer to perform their respective promises, unless such performance is dispensed with or excused under the provisions of this Act or of any other law...” Example: X bought goods from Y and promised to pay Rs.1000 to Y on 10th June. X went to Y on 10th June to give Rs.1000 in cash but Y did not accept it. Though X may not be discharged from the payment of Rs.1000 but he would not be liable to pay interest thereon from 10th June onwards. For a tender to become legally valid it must fulfill the following conditions:

- (i) **It should be unconditional** (Sec. 38): The promisor while offering to perform his promise must do it unconditionally.
- (ii) **Offer must not be of a part only** (Sec. 38): The offer must be of whole payment or performance. A creditor is not bound to accept less than what is actually due and would not lose his right to interest on that portion.
- (iii) **Proper time and place** (Sec. 38): The offer must be made at a proper time and place.
- (iv) **Able and willing** (Sec. 38): “It must be made... under such circumstances that the person to whom it is made may have a reasonable opportunity of ascertaining that the person by whom it is made is able and willing there and then to do the whole of what he is bound by his promise to do.”
- (v) **Reasonable opportunity** (Sec. 38): “...If the offer is an offer to deliver anything to the promisee, the promisee must have a reasonable opportunity of seeing that thing offered is the thing which the promisor is bound by this promise to deliver. Thus buyer must have reasonable opportunity to ascertain that the goods offered are contracted for.
- (vi) **Tender of money: A tender of money must be in legal tender money, and not in any foreign currency, promissory note or cheque’**
- (vii) **Joint Promisees:** (Sec. 38) “An offer to one of several joint promises has the same legal consequences as an offer to all of them.”

(B) Refusal to Perform (Sec.39)

“When a party to a contract has refused to perform, or disabled himself from performing, his promise in its entirety, the promisee may put an end to the contract, unless he has signified, by words or conduct, his acquiescence in its continuance.”

(C) Who Can Demand Performance?

It is only the promisee who can demand performance of the promise under a contract, for the general rule is that “a person cannot acquire rights under a contract to which he is not a party.”

(D) By Whose Contracts must be performed

1. By the promisor himself: (Sec. 40) “If it appears from the nature of the case that it was the intention of the parties to any contract that any promise contained in it, should be performed by the promisor himself, such promise must be performed by

the promisor” Generally where personal skill, taste etc are involved, it is presumed that the promisor would himself perform the contract.

2. By promises representative: (Sec. 37) “...Promises bind the representatives of the promisors in the case of death of such promisors before performance, unless a contrary intention appears from the contract”. Example: A promises to deliver goods to B on a certain day on payment of Rs.10, 000. A dies before that day . A’s representatives are bound to deliver the goods to B, and B is bound to pay Rs.10, 000 to A’s representatives.

(E) Offer to Perform (Tender) (Sec 37) “A party who has not already performed his obligation must offer to perform the same. (Sec. 38) “Where a promisor has made an offer of performance to the promisee, and the offer has not been accepted, the promisor is not responsible for non-performance, nor does he thereby lose his rights under the contract”. Example: A promises to paint a wall for B. A must perform this promise personally.

(F) Devolution of Joint Rights and Joint Liabilities (Joint Promises): When two or more persons make a joint promise to other or others, they are known as joint promisors e.g. A and B sign a promissory note, they are joint promisors. When a promise is made to two or more persons, they are Joint Promises. Following rules govern such promises:

1. All promisors must jointly fulfill the promise;
2. Any one of the joint promisors may be compelled to perform;
3. Right of contribution between joint promisors: (4) Effect of release of one joint promisor. Example: A, B and C Jointly promise to pay D Rs. 5000. D may compel either A or B or C to pay him Rs. 5000.

(G) Time and Place for Performance

1. **Within a reasonable time:** (Sec 46)“Where a promisor is to perform his promise without application by the promisee, and no time for performance is specified, the engagement must be performed within a reasonable time.” “The question what is a reasonable time is, in each particular case, a question of fact.”
2. **During usual hours of business:** (Sec.47) “When a promise is to be performed on a certain day, and the promisor has undertaken to perform it without application by the promisee, the promisor may perform it at any time during the usual hours of business on such day and at the place at which the promise ought to be performed.”
3. **Promisee’s duty to apply for performance:** (Sec. 46) “When a promise is to be performed on a certain day, and the promisor has not undertaken to perform it without application by the promisee, it is the duty of the promisee to apply for performance at proper place and within the usual hours of business.”
4. **Promisor should apply for fixing a reasonable place:** (Sec.49) “When a promise is to be performed with application by the promisor and no place is fixed for the performance of it, it is the duty of the promisor to apply to the promisee to appoint a reasonable place for the performance of the promise, and to perform it at such place.”

5. **In the manner prescribed by promisee:** (Sec. 50) “The performance of any promise may be made in any manner, or at any time which the promisee prescribes or sanction.”

(H) Performance of Reciprocal Promises (Sec. 2 (f)] “Promises which form the consideration or part of the consideration for each other are called reciprocal promises.” Rules regarding the performance of reciprocal promises are:

1. **When promises are to be performed simultaneously:** “When a contract consists of reciprocal promises to be simultaneously performed no promisor need perform his promise unless the promisee is ready and willing to perform his reciprocal promise.”
2. **In the order, which the nature of transaction requires:** (Sec. 52) “Where the order in which reciprocal promises are to be performed is expressly fixed by the contract, they shall be performed in that order; and where the order is not expressly fixed by the contract, they shall be performed in that order which the nature of the transaction requires.”
3. **When the performance of a promise is dependent upon other:** (Sec. 54) “When the contract consists of reciprocal promises, such that one of them can not be performed or that its performance cannot be claimed till the other has been performed and the promisor of the promise last mentioned fails to perform it, such promisor cannot claim the performance of the reciprocal promise, and must make compensation to the other party for any loss which such other party may sustain by the non-performance of the contract.” These are known as mutual and dependent promises.
4. **When one party prevents the other from performing his promise:** (Sec.53) “When a contract contains reciprocal promises, and one party to the contract prevents the other from performing his promise the contract becomes voidable at the option of the party so prevented.
5. **Where the promise is partly legal and partly illegal:** (Sec.57) “Where persons reciprocally promise, firstly, to do certain things which are legal, and secondly, under specified circumstances, to do certain other things which are illegal the first set of promises is a contract, but the second is a void agreement.”

(I) Time of Performance

1. **When time is the essence of the contract:** (Sec.55) “When a party to a contract promises to do certain thing at or before a specified time, or certain things at or before specified times, and fails to do any such thing at or before the specified time, the contract, or so much of it as has not been performed, becomes voidable to the option of the promisee, if the intention of the parties was that time should be the essence of the contract.”
2. **When time is not the essence of the contract:** If it was not the intention of the parties that time should be the essence of the contract, the contract does not become voidable by the failure to do such thing at or before the specified time, but the promisee is entitled to compensation from the promisor for any loss occasioned to him by such failure.

3. **Condition for compensation when contract is voidable and goods are accepted:** “If in case of a contract voidable on account of the promisor’s failure to perform his promise at the time agreed, the promisee accepts performance of such promise at any time other than that agreed, the promisee cannot claim compensation for any loss occasioned by the nonperformance of promise at the time agreed unless, at the time of such acceptance, he gives notice to the promisor of his intention to do so.” (Sec.55)

Discharge of a Contract

A contract is discharged, terminated when the rights and obligations created by it come to an end. A contract is terminated in the following ways:

1. **By performance** (Sec. 37): When the parties to a contract perform their respective promises, the contract comes to an end. Nothing remains to be performed.
2. **By Tender (Attempted Performance):** When a promisor makes an offer of performance tender and the offer is not accepted, the promisor is not responsible for non-performance, i.e. he is discharged from his obligations under the contract. But he does not lose his rights under the contract i.e. the promisee is not discharged from his obligations.
3. **By Supervening Impossibility:** Impossibility is of two types:
 - a. **Impossibility at the Time of Contract:** (Sec.56) “An agreement to do an act impossible in itself is void.”: Example A agrees with B to discover gold by magic. The agreement is void.
 - b. **Subsequent or Supervening Impossibility:** Where a contract originates as one capable of performance but later due to change of circumstances its performance becomes impossible, it becomes void by subsequent or supervening impossibility (section 56). In English law this is called “Doctrine of Frustration”. Example: A and B contract to marry each other. Before the time fixed for marriage, B becomes mad. The contract becomes void.

Supervening impossibility may arise in any of the following ways:

- (1) **Destruction of the subject matter:**
- (2) **When the foundation of the contract ceases to exist:** If in a contract, it is deemed that the parties had assumed certain state of things to continue and that state of things ceases to exist, the contract would come to an end.
- (3) **Change of Law:** A contract which becomes illegal after it is made, becomes void and the parties to the contract will be discharged from their respective obligations.
- (4) **Death or personal incapacity:** Where the contract is of personal nature the death or incapacity of the promisor would discharge the contract.
- (5) **Declaration of war:** A contract entered into with an alien enemy before the war breaks out is either suspended or discharged after the declaration of war if it does not aid the enemy in the pursuit of war, it is suspended and would be performed after the war is over, otherwise it is terminated

and the parties to the contract are discharged from their respective obligations.

- 4. Exceptions to the Principle of Supervening Impossibility:** Impossibility as a rule is no excuse for non-performance: Following are some of the circumstances in which non-performance of a contract was held not to be excused.
- (1) **Difficulty of performance:** If a contract becomes difficult to perform but not impossible the promisor would not be discharged on that account.
 - (2) **Commercial Impossibility** would not discharge of a contract. A contract would not be deemed to be impossible because it does not remain profitable to the promisor or would make the promisor to incur losses.
 - (3) **Action of a third party:** If a man chooses to answer for the voluntary act of a third person there is no reason in law or justice why he should not be held for his inability to procure that act.
 - (4) **Strikes, lock-outs, civil disturbances and riots** do not discharge a contract unless there is a clause in the contract to that effect.
 - (5) **Partial impossibility:** Where a contract is entered into for more than one purpose, the contract would not become impossible if one of the objects has become impossible to achieve.

Consequences of Supervening Impossibility

Supervening impossibility makes a contract void. The parties are discharged from their respective obligations under the contract (Sec. 65). The party who has received any advantages under it should restore it to the other party.

5. Mutual Agreement

A contract is created by the parties to it; therefore, it can also come to an end by their mutual agreement. Termination by mutual agreement may occur in any one of the following ways.

- (1) **Novation:** When a new contract is substituted for an existing contract, either between the same parties or between different parties, it is called novation.
- (2) **Alteration:** When one or more of the terms of a contract are changed it is called alteration. In case of alteration, parties to the contract do not change.
 1. Example: A agrees to supply to B 20 readymade pants, 10 of the size 32 and 10 of the size 34. Later on B requests A to supply all 20 pants of the size 32 only. A agrees to it. The old contract comes to an end.
- (3) **Rescission:** When both the parties to a contract agree to put an end to the contract, without performing it, the contract is said to be rescinded by mutual agreement. Example: A promises to supply to B 20 shirts on 15th January and B promises to pay Rs 5000 on the same day after delivery, on 10th January. Both the parties agree that the contract would not be performed. Parties are said to have rescinded the contract.
- (4) **Remission:** When a party to a contract accepts, from the other party, a performance lesser than what he had contracted for, he is deemed to have remitted the remaining performance, and the contract is discharged.

Example: A owes B Rs.500 rupees but pays on by Rs. 200, and B accepts at in satisfaction of the whole debt. The whole debt is discharged.

- (5) **Waiver:** When a party to a contract abandons his right under the contract, the other party is released from his obligations. Example: A pays Rs 1000 to B to paint a wall for him. Later on A forbids B to paint the picture. B is no longer bound to perform the promise.
- (6) **Merger:** When a superior right and an inferior right coincide and meet in one and the same person, the inferior right vanishes into the superior right. This is known as merger. Example: A has taken a house on lease from B for 10 years. After one year A buys the house from B. His rights of a lessee vanish into his rights of ownership and the contract of lease comes to an end.

6. By Lapse of Time

The Limitation Act provides the time limit in which certain rights can be enforced. If that time limit expires, the promisee cannot enforce the promisor and promisor is discharged. Example: A owes Rs 10,000 to B. The last date for the repayment of the loan has expired and B does not file a suit against A for two years. B loses the right to recover the money back.

7. By Operation of Law

This covers the following cases:

1. **Death:** If a contract involves personal skill or ability, death of the promisor would terminate the contract.
2. **Insolvency:** When a person is adjudged insolvent and hands over all his property to the official receiver/assignee, he is supposed to have the right to earn his livelihood in the ordinary way and therefore the courts, under certain circumstances and subject to certain conditions, discharge him from all debts which were payable in insolvency but remain unpaid. He does not remain liable to pay those debts.
3. **Merger**
4. **Material alteration:** A change which affects or alters, in a specific manner, the rights and liabilities of the parties is called material alteration. A material alteration made in a written document or contract by one party without the consent of the other, will make the contract void, e.g. an indorsee of a promissory note/ altering the amount of note.

8. By Breach of Contract

Breach is the non-performance of the promise by the promisee by the promisor. It entitles the promisee to rescind the contract. It, therefore, operates as a mode of discharging a contract.

Breach of Contract and its Remedies

As we discussed in the previous part breach of contract is a mode of discharge of the contract. Though the obligation created by the contract comes to an end but the aggrieved

party is entitled to several remedies that are discussed in this part. The remedies depend upon whether the breach is (a) Actual or (b) Anticipatory or Constructive.

1. Actual Breach

Where a person fails to perform a contract when the performance is due, the other party can hold him liable for breach i.e. he can rescind the contract and sue for damages.

(A) At the time when performance is due: When a party to the contract fails to perform or refuses to perform his obligations at the time when the performance is due, he is committing a breach of contract. Example: A promised to supply B, 500 tables on 10th Jan. A does not supply the Tables on 10th Jan. A is guilty of breach of contract and B becomes the aggrieved party.

(B) During the performance of the contract: When a contract is being performed the promisor fails to perform the promisee to accept the remaining part, it is also a breach of contract. If the promisor is not allowed to perform the remaining part then the promisee has committed a breach of contract. Example: The defendant Co. agreed to buy 4000 tons of goods. After 2000 tons of goods had been delivered the company told the plaintiff that it did not require any more goods. The company committed a breach of contract.

2. Anticipatory Breach

When a party to the contract, before the date of performance arrives, repudiates his liability under the contract or makes the performance of the contract impossible, there is an anticipatory (constructive) breach of contract. Anticipatory breach may be express or implied. Example: A promises to marry B in the month of April. But in the month of March A marries C. The marriage between A and B becomes impossible, this is a case of anticipatory breach.

Consequences of Anticipatory Breach: If a promisor is guilty of anticipatory breach, the promisee has got two options open to him:

- He may treat the anticipatory breach as the actual breach of contract and can rescind the contract.
- He may ignore the notice or the conduct of the promisor and may wait till the due date of performance and then if the promise is not performed he may treat it as breach of contract. If the promisee chooses the second course of action, he keeps the promise alive for the benefit of the promisor also and may lose his right to sue the promisor if (i) The promisor performs the promise on the due date: (ii) They develop circumstances which discharge the contract legally.

Remedies of Breach of Contract

When a contract is broken the party who suffers from such breach is entitled to the following relieves:

1. **Rescission of the contract:** He would not be required to perform his promises. Example: A, an advocate promises to plead B's case in the court of law if B gets him (A) a table before the date of hearing. B does not deliver a table to A. A can rescind the contract and becomes free from the obligation of pleading B's case.
2. **Suit for Damages:** The injured party can also file a suit for compensation for the loss it has suffered because of the breach of the contract. Example: A contracts to buy B's car for Rs. 60,000 but B breaks his promise. B must pay to A, by way of

compensation, the excess, if any, of the contract price which B can obtain for the car at the of the breach of promise.

3. **Suit upon Quantum Meruit:** The expression 'Quantum Meruit' means 'as much as earned', i.e. reasonable remuneration for the services performed. The rule is invoked where there is no agreement for remuneration for the work done. Thus where a party to the contract has performed part of his promise and is prevented by the act or conduct of the other party, from completing it, he may sue on a Quantum Meruit. Example: A agreed to write a story for B, which B would publish in installments in his weekly magazine. B agreed to pay a lump sum amount for the entire story. After a few installments were published, B abandoned the magazine. Held A could recover on Quantum Meruit for the work done under the contract.
4. **Suit for Specific performance of the contract:** Specific performance means the actual carrying out of the contract. In certain cases the court may direct the party in default to fulfill his promise. This remedy may be granted to the injured party instead of or in addition to the awarding of damages. It is usually granted where monetary compensation is not an adequate remedy. But it would not be granted if the court cannot supervise the contract (e.g. mining operations) or if the contract is for personal services. Example: A, a renowned painter agrees to paint a picture for B. Later on he refuses to do so. B pleads with the court that he cannot get such a painting with any amount of money. Even if court is satisfied with the plea of B, it cannot grant specific performance because A cannot be compelled to paint a picture.
5. **Suit for Injunction:** Injunction is the specific performance of the negative terms of the contract. It is an order of the court prohibiting a party from doing something. Example: A agrees to do a musical programme at the theatre of B on the eve of the Christmas and also agrees not to perform in any other theatre on that day. Later on A agrees to perform in the theatre of P. B cannot enforce a specific performance of A's musical programme in his theatre (because court cannot effectively supervise it) but he can ask the court to restrain A from performing in P's theatre.

Rules Regarding Damages

Damages under Contract act are awarded by way of compensation for loss to the plaintiff only and not by way of punishment to the guilty party. Following are the rules for the damages:

1. When a contract is broken, only those damages "which naturally arose in the usual course of things from such breach" can be recovered. These are known as general or ordinary damages.
2. In certain cases even special damages can also be recovered. Special damages are those 'which the parties knew, when they made the contract to be likely to result from the breach of it.' (Sec. 73)
3. Compensation for the breach of quasi contract would be the same as the compensation for the breach of contract.

4. "In estimating the loss of damage, arising from a breach of contract, the means which existed of remedying the inconvenience caused by the nonperformance of the contract must be taken into account".
5. Under a contract for the sale of goods the measure of damages is the difference between the contract price and the market price at the date of breach.
6. Damages are not awarded with a view to punishing the defendant except –
 - a) For a breach of promise to marry; and
 - b) For a wrongful dishonour by the banker of cheque of the customer. These are known as Exemplary or Vindictive Damages.
7. In case the court finds that though the defendant has been guilty of a breach of contract, the breach has not caused any appreciable loss to the plaintiff, it awards only nominal damages, like costs of the suit etc.
8. Even if the parties agree about damages for breach of contract, only actual damages, not exceeding the agreed amount, can be recovered. These are known as liquidated damages (Sec.74)
9. Plaintiff would not be denied damages for the loss suffered on the ground that the assessment of damages is difficult. (Sec.75).
10. Mitigation of loss: it is the duty of the plaintiff to take steps to minimize the loss resulting from breach.
11. Cost of suit: The plaintiff can recover not only damages for the loss sustained but also costs of getting the decree of damages.
12. Interest as damages: As regards breach of contract of sale, the court is empowered to award interest, at such rate as it thinks fit, on the amount of the price.

Kinds of Damages

(1) General or Normal Damages: The amount of general or ordinary damages is restricted to only that loss which arises :(a) naturally and (b) in the usual course of things from such breach (Sec. 73)

(2) Special Damages means loss which would result not in the ordinary course, but because of special circumstances and the parties know, at the time when they entered into the contract, that this is likely to result from the breach of it.

(3) Liquidated Damages: (Sec. 74) "When a contract has been broken, if a sum is named in the contract as the amount to be paid in case of such breach, or if the contract contains any other stipulation by way of penalty, the party complaining of the breach is entitled whether or not actual damage or loss is proved to have been caused thereby, to receive from the party who has broken the contract reasonable compensation not exceeding the amount so named or, as the case may be, the penalty stipulated for".

Example: A contracts with B to pay B Rs.10000, if he fails to pay B Rs. 9000 on a given day. A fails to pay B Rs.9000 on that day. B is entitled to recover from A such compensation, not exceeding Rs. 10000, as the court considers reasonable.

(4) Vindictive or exemplary Damages: As explained earlier, damages for breach of contract are granted to compensate for the loss suffered by the plaintiff and not with a view to punish or penalize the wrong done by the defendant. Hence the damages granted are not vindictive, exemplary or 'punitive'. However there are following two exceptions to this general rule.

- a. In case of a breach of promise to marry.
- b. In case a banker, wrongfully, dishonoring the cheque of a customer having sufficient funds to his credit. The rule of damages'. "A stipulation for increased interest from the date of default may be a stipulation by way of penalty" [Sec.74].

(5) Nominal Damages: Where the aggrieved party does not suffer any monetary loss, sometimes the Courts grant a nominal amount like cost etc. just to establish that the plaintiff has won the case against the defendant.

6.4 CONTRACT OF AGENCY

Definition of Agent and Principal (Sec. 182):

"An agent is a person employed to do any act for another or to represent another in dealing with third persons. The person for whom such act is done or who is so represented is called the principal."

Test of Agency:

The true test of agency is the authority that one person possesses to create contractual relationship between the person he is representing and the person to whom he represents. Where a person is in the habit of advising another in business dealings he does not become the agent of the other.

Agent and Servant:

A servant is a person who acts under the direct control and supervision of his master while an agent does not. "A principal has the right to direct what the agent has to do; but a master has not only that right but also the right to say how it is to be done" An agent is, therefore, sometimes described as 'Superior Servant. An agent binds the principal with the third parties but a servant does not create relations between his master and third persons.

Who may employ agent? (Sec. 183):

"Any person who is of the age of majority according to the law to which he is subject, and who is of sound mind, may employ an agent."

"Whatever a person can do personally he can do through an agent." Thus a guardian of a minor can appoint an agent for the minor.

Who may be an agent? A minor or even a person of unsound mind can act as agents but they would not be responsible to the principal or to the third parties in cases where a person competent to contract would have been responsible.

Consideration for the contract of agency: (Sec. 185) "No consideration is necessary to create an agency." Principal's agreement to be represented by the agent is deemed to be sufficient detriment to support the promise by the agent to act as such and be liable to the principal for negligence.

Creation of Agency

The relationship of principal and agent may be created in any of the following ways:

(1) By Express Agreement: "The authority of an agent may be express or implied." (Sec. 186) "An authority is said to be express when it is given by words spoken or written." (Sec. 187): Example: A asks B to sell his cow for a commission of 10% on sales. B agrees to do so. Agency has been created. The agreement need not be in writing.

But in certain cases, law requires the agreement to be in writing, e.g. for sale or purchase of land, the law requires the agent to be appointed by executing a formal power of attorney.

(2) By Implied Agreement Sec. 187: "... An authority is said to be implied when it is to be inferred from the circumstances of the case, and things spoken or written, or the ordinary course of dealing..." Example: A owns a shop. The shop is managed by B, and he is in the habit of ordering goods from C in the name of A for the purposes of the shop, and of paying for them out of A's funds with A's knowledge. B has an implied authority from A to order goods from C in the name of A for the purposes of the shop.

- (i) **Agency by estoppels (Sec. 237):** "When an agent has without authority done acts or incurred obligations to third persons on behalf of his principal, the principal is bound by such acts or obligations if he has, by his words or conduct, induced such third persons to believe that such acts and obligations were within the scope of the agent's authority." Example: A starts manufacturing plastic products. A, B and C are sitting together. B in the present of A tells C that A has appointed him (B) as selling agent of his product. A does not contradict this statement, though he had not appointed him as his agent. Later on C enters into a contract with B on the presumption that B is A's agent. A would be bound by this transaction. A would be precluded from denying that B is his agent.
- (ii) **Agency by holding out:** The principle of holding out is a part of the law of estoppels. But agency by holding out requires some positive or affirmative conduct by the principal. Example: A sends his servant to buy goods from B on credit. B gives the goods to A's servant and A pays for them. Later on A's servant, without A's asking for it, buys goods from B on A's credit and runs away. A would be liable to pay for the goods, though a servant is not an agent, but by paying for the credit purchases made by his servant, A held out that his servant was his agent also and as such he would be liable for the purchases made by his servant.
- (iii) **Agency of Necessity:** If a person protects the property or interest of another where such property or interests are in imminent danger and the instructions of the owner cannot be obtained, the former would be deemed to be an agent of the latter so as to make the latter liable for whatever he has done provided the former has acted bonafide in the interests of the latter. The principle of necessity also extends to cases where an agent exceeds his authority if the following conditions are fulfilled:
 - The agent was not in a position to communicate with the principal;
 - The agent takes reasonable and necessary course in the circumstances;
 - The agent acts bonafide. Example: A sends some bananas to B with the instructions that B should send them to C. When B takes delivery of the bananas, he finds that the bananas are not in a condition to sustain the journey to C's place and would perish before reaching. B, therefore, sells them at the best possible price. A would be bound by this sale under agency by necessity.

In cases of accident and emergency a master of a ship can sell or pledge the goods in order to save their value and such sale or pledge would be binding on the owners of the cargo.

Husband and Wife: A wife can bind the husband for the contracts she enters into for the purchase of household necessities suiting to the couples joint style of living provided they are living together and the wife is the in-charge of domestic establishment and the husband has not made reasonable allowance to the wife for her needs. Example: H and W are husband and wife respectively. W chooses to live separately and buys goods on credit from A. On her failure to pay for the purchases A cannot recover the money from H because they are not living together. However, a husband can escape the liability if he can prove that (i) he had warned the tradesman from supplying the goods on credit to his wife; (ii) he had already supplied sufficient articles in question to his wife (iii) he had supplied sufficient means to his wife for the purchase of articles in question. But if the wife is deserted by her husband and thus forced to live separately, she may of necessity become agent of her husband and can pledge her husband's credit for necessaries to the extent a reasonable maintenance makes it necessary.

(3) Agency by Ratification: A person may become another's agent after having done some work for the latter, if the latter ratifies the act. When a person adopts or accepts an act done on his behalf but without his authority he is said to have ratified it. Example: A, without authority, buys goods for B. Afterwards B sells them to C on his own account; B's conduct implies a ratification of the purchase made for him by A. Implications of Ratification:

(i) Ratification relates back to the date of the act. It is tantamount to prior authority. This means that the agency comes into existence not from the time when the act is ratified but from the time when the act was done. i.e. (Ratification is equivalent to an antecedent authority).

(ii) No Authority for future: The ratification of an act done without authority does not confer authority to do similar acts in future.

Conditions of a Valid Ratification

Ratification is enforceable only when the following conditions are fulfilled.

1. **Must contract as agent:** The agent must contract as agent for a principal in contemplation; or the agent should not make the contract for himself.
2. **Only named Principal can ratify:** Only that principal who was named or was identifiable at the time of the contract, can ratify the contract. He can do so even if the agent never intended that he should do so. Example: A make a contract with B on behalf of his uncle, D. Later on C, A's elder brother want to have the benefit of the contract and wants to ratify the same. C cannot do so. D, when comes to know of the contract, wants to ratify the same; he can do so and enjoy the benefit of the contract even if A does not want it.
3. **The principal should be in existence:** Mere contemplation at the time of the contract is not sufficient. If the principal was not in existence at the time of the contract, he cannot ratify such contract.

4. **The Principal must be competent to contract** at the date of the contract as well as at the date of ratification. Thus a minor cannot ratify a contract made on his behalf after becoming a major.
5. **The principal must have full knowledge of the material facts** (Sec. 198): “No valid ratification can be made by a person whose knowledge of the facts of the case is materially defective.”
6. **The principal must ratify the whole transaction** (Sec. 199).
7. **The principal must ratify the contract within a reasonable time** after the contract is made.
8. **The act to be ratified should not be void or illegal** though ratification can be made of voidable contracts or even of tortuous acts.
9. **Ratification of unauthorized act cannot injure third person.**
10. **Ratification by Government:** Acts done by public servant in the name of the Government may be ratified by subsequent approval in the same manner as private transaction.

Extent of Agents Authority

It is necessary to know all dimensions of his (agent) authority. They are as follows:

(A) Actual Authority: Actual authority is one which is conferred on the agent by the principal. It may be express or implied.

1. Express Authority: An authority is said to be express when it is given by words spoken or written (Sec. 187).
2. Implied Authority: (i) An authority is said to be implied when it is inferred from the circumstances of the case.(Sec. 187) (ii) An agent having authority to do an act has authority to do every lawful thing which is necessary in order to do such act. (Sec. 188)

(B) Ostensible or Apparent Authority: Apparent or ostensible authority is that authority which an agent appears to be possessing though in fact he may not have.

(C) Authority in Emergency: “An agent has authority, in an emergency; to do all such acts for the purpose of protecting his principal from loss as would be done by a person of ordinary prudence, in his own case, under similar circumstances.” (Sec. 189).

DELEGATION OF AUTHORITY BY AGENT

“An agent cannot lawfully employ another to perform acts which he has expressly or impliedly undertaken to perform personally...” sub-agent may not enjoy the confidence of the principal [“A subagent is a person employed by, and acting under the control of, the original agent in the business of the agency” (Sec.191).

Exceptions: In the following circumstances delegation made by an agent to subagent would be proper:

- (1) **Nature of agency;**
- (2) **Custom of Trade:** Where it is a custom of trade that an agent appoints a sub-agent;
- (3) **Ministerial Acts:** Where the acts to be done are purely ministerial and do not involve the exercise of discretion, or personal or professional skill;
- (4) **Express Delegation:** Where the principal has expressly permitted delegation;
- (5) **Implied Permission:** Where the principal impliedly permits delegation i.e. from act or conduct it may be inferred that he has allowed delegation of authority;
- (6) **In emergency:** In case of emergencies an agent can always delegate the authority to a subagent.

Duties of an Agent

(1) **To follow principal's directions or customs:**

(2) **Skill and diligence to work:**

(3) **To render proper account:** (Sec. 213): "An agent is bound to render proper accounts to his principal on demand." He should always be ready to produce them to the principal.

(4) **To communicate with the principal** (Sec. 214)

(5) **Not to deal on his own account:** (Sec. 215)

(6) **To pay sums received for principal**

(7) **Not to delegate authority** (Sec. 190)

(8) **On Principal's death or insanity** (Sec. 209)

Rights of an Agent

(1) **Right to Remuneration:** Every agent is entitled to receive the remuneration agreed upon with the principal.

(2) **Right of retainer** (Sec. 217)

(3) **Right of Lien** (Sec. 221)

(4) **Right of indemnity**

Rights and duties of principal towards agent Rights of principal

1. He can enforce the various duties of an agent.
2. He can recover compensation for any breach of duty by the agent.

3. He can forfeit agent's remuneration where the agent is guilty of misconduct in the business of agency.
4. Principal is entitled to any extra profit that the agent has made out of his agency. This includes illegal gratification, if any.
5. Principal is entitled to receive all sums that the transactions, entered into, by the agent, on behalf of the principal were void or illegal.

Duties of Principal

1. To Pay Remuneration:
2. Duty to Indemnify:
3. Compensation for injuries:
4. Should not prevent the agent from earning remuneration

Principal's Liabilities to Third Parties for the Acts of the Agent

- (1) Liability for acts done by agent within authority
- (2) Ratification of acts beyond the scope of his authority
- (3) When an agent commits fraud or misrepresentation

Liability for tort: If an agent commits a tort in the course of and within the scope of his agency, the principal may in certain cases be liable for the same.

- (1) **Notice given to agent as notice to principal (Sec. 229)**
- (2) **Liability under the principle of estoppels**
- (3) **Liability when his name is not disclosed (Unnamed principal)**
- (4) **Liability when agent does not disclose his agency (undisclosed principal)**

Agent and Third Parties

“In the absence of any contract to that effect, an agent cannot personally enforce contract entered into by him on behalf of his principal nor is he personally bound by them...”

If there is no contract providing for, or relieving the agent from, personal liability the agent would be liable in the following cases:

- (1) **Foreign Principal;**
- (2) **Unnamed Principal;**
- (3) **Undisclosed Principal;**
- (4) **Incompetent Principal;**
- (5) **Where the agent exceeds his authority;**
- (6) **Where agent's authority is coupled with interest;**
- (7) **Custom of Trade;**
- (8) **Money received by mistake or fraud.**

Termination of Agency

The contract of agency would come to an end in any of the following circumstances:

(1) By Agreement;

(2) By Revocation by the principal:

- (i) If the authority has not been exercised;
- (ii) Revocation may be expressed or implied (Sec. 207);
- (iii) Reasonable Notice of revocation;
- (iv) Compensation: If the principal revokes the agency, without sufficient cause, he would have to compensate the agent for the premature termination. (Sec. 205)
- (v) Agency is irrevocable in the following cases.

- a. Agency coupled with interest;
- b. Where agent has partly exercised his authority
- c. Where an agent has incurred personal liability

(3) Renunciation by the Agent;

(4) Completion of business;

(5) Death or Insanity;

(6) Insolvency of the principal;

(7) Expiration of Time;

(8) Destruction of the subject matter;

(9) Dissolution of a company;

(10) Principal or agent becoming alien enemy;

6.5 REVIEW QUESTIONS

1. "Every contract is an agreement but every agreement is not a contract". Do you agree with this statement?
2. "Performance of the conditions of a proposal is an acceptance of the proposal"- Comment.
3. "A Promise against a promise is a good consideration" - Comment.

BUSINESS LAW PART II

Structure

- 7.1 Partnership Act, 1932
- 7.2 Sales of Goods Act, 1930
- 7.3 Law of Insurance
- 7.4 The Negotiable Instruments Act, 1881
- 7.5 Review Questions

7.1 PARTNERSHIP ACT, 1932

The law relating to partnership is contained in the Indian partnership Act, 1932. The Act came into force with effect from October 1, 1932. Prior to enactment of the aforesaid Act, partnership business used to be governed by the Indian Contract Act, 1872. Section 4 of the Indian Partnership Act, 1932 defines ‘partnership’ as follows:

“A business carried on by all or any of them acting for all.”

Essential elements of partnership:

- (1) Association of two or more persons;
- (2) Existence of a contract;
- (3) Carrying on a business;
- (4) Sharing of profits; and
- (5) Prevalence of mutual agency.

But a partnership firm cannot create another partnership as it does not enjoy the status of the artificial legal person. There must exist a contract between persons who have agreed to form partnership. Such a contract may, however, be expressed or implied, written or oral.

Partnership Deed: Partnership Deed is the document that defines the rights and obligations of partners. Besides names, address and occupation of partners it lays down the duration of partnership, nature of business, profit sharing ratio, right to interest, salary, commission etc.

Registration of Firms

The registration of partnership firm is discretionary. The provisions relating to registration of partnership firm are contained in Chapter 7, Sections 56 to 71 of the partnership Act.

Effect of Non-registration (Sec. 69)

An unregistered firm and its partners suffer from the following disabilities:

- (1) No Suit against other partners and firms
- (2) No suit against third parties
- (3) No claim of set off

Duration of Partnership

Partnership may, from the point of view of its duration, be categorized into the following two classes:

- (1) Partnership for a fixed term or particular partnership
- (2) Partnership at will.

Kinds of Partners

There may be different kinds of partners in a partnership firm. The important classification of partners is given below:

- (1) Actual or active partners,
- (2) Dormant or sleeping partner,
- (3) Nominal partner,
- (4) Partner in profits only,
- (5) Sub-partner,
- (6) Partner by estoppels or by holding out.

(1) Actual or active partners: Partners actively engaged in the conduct of the business are known as 'active' or 'actual' or ostensible partners.

(2) Dormant or sleeping partner: The nominal partner is one who lends his name to the partnership firm without any real interest in terms of investing money in the firm or sharing in profits.

(3) Nominal partner: the nominal partner is known to the outsiders and does not share the profits of the firm.

(4) Partner in profits only: A person who does not want to take risk of loss may agree to become a partner in profits only.

(5) Sub-partner: When a partner agrees to share his share of profit in a partnership firm with the outsiders, such an outsider is called a 'Sub-partner'.

(6) Partner by estoppels or by holding out: If a partner, by his words or conduct holds out to another that he is a partner, he will be stopped from denying that he is not a partner. Such a partner neither contributes any capital nor participates in the management. He is only liable to third parties.

Minor as a Partner

According to Indian Contract Act an agreement of a minor is void, as void; as such he cannot enter into an agreement of partnership. Section 30 of the Partnership Act provides that a minor may be admitted to the benefits of partnership with the consent of all the partners.

Rights of Minor Partner

A minor admitted to the benefits of a Partnership has the following rights:

- (1) Right to share the profits;
- (2) Right to have the access to do the inspection;
- (3) Right to file a suit for accounts or demand his share of property or profits;
- (4) Right to exercise option on attaining the age of majority, whether or not to continue in the firm.

Liabilities of Minor Partner

1. The liability of a minor is limited to the extent of his share in the firm and therefore, unlike other partners, he is not personally liable.
2. If the firm is declared insolvent his share in the firm vests in the official receiver or assignee but a minor cannot be declared insolvent.

Rights, Duties and Liabilities of Partners

Rights

- (1) Right to take part in the conduct of business
- (2) Right to be consulted
- (3) Right of Access to the books
- (4) Right to share profits
- (5) Right to interest on capital
- (6) Right to interest on advances
- (7) Right to indemnity
- (8) Right to act prudently in emergency
- (9) Right to give consent for admission of a new partner
- (10) Right to retire
- (11) Right to carry on competing business after retirement.

Duties

(A) Qualifying

- (1) To attend his duties diligently
- (2) To work without remuneration
- (3) To contribute to losses
- (4) To indemnify for willful neglect
- (5) To use firm's a property exclusively for the firm
- (6) To account for private profits [Sec.16(a)]

(B) Others

- (1) Duty to carry on business for the common advantage
- (2) To indemnify for loss caused by fraud
- (3) To give full information
- (4) To render true accounts
- (5) To be just and faithful

Liabilities

- (1) **Liability of partner for acts of the firm:** Every partner is liable, jointly with all the other partners and also severally, for all acts of the firm done while he is a partner
- (2) **Liability of the firm for wrongful acts of the partner:** Where, by the wrongful act or omission of a partner acting in the ordinary course of the business of a firm, or with the authority of his partners, loss or injury is caused to any third party, or any penalty is incurred, the firm is liable therefore to the same extent as the partner (Section 26).
- (3) **Liability of the firm for misapplication by partners:** (i) When a partner acting within his apparent authority receives money or property from a third party and misapplies it, or (ii) A firm in the course of its business receives money or property from a third party, and the money or property is misapplied by any of the partners while it is in the custody of the firm, the firm is liable to make good the loss.
- (4) **Liability for the loss caused by his own fraud**
- (5) **Liability for the loss caused by his own willful neglect.**

Authority of a Partner

(A) Express Authority

(B) Implied Authority

“The act of partner which is done to carry on, in the usual way, business of the kind carried on by the firm, binds the firm”. Thus the authority of a partner to bind the firm is called ‘Implied authority’.

(C) Authority in an Emergency: A partner has authority in an emergency to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances, and such acts bind the firm.

Reconstitution of A Firm

A change in the constitution of the firm occurs when a new partner is admitted or an old partner retires or dies. The partnership is reconstituted on:

- (1) Admission
- (2) Retirement
- (3) Expulsion
- (4) Insolvency
- (5) Death of a partner
- (6) Transfer of interests by a partner.

Dissolution of a Firm

Dissolution of a firm means an end of the firm. The Indian Partnership Act distinguishes between:

- (a) Dissolution of firm, and
- (b) Dissolution of partnership.

Section 39 provides that the dissolution of partnership between all the partners of a firm is called the “dissolution of the firm”.

Modes of Dissolution

A firm may be dissolved in any of the following modes

(I) By Agreement (sec. 40);

(II) By Notice (sec. 43);

(III) On the Happening of Certain Contingencies (sec. 42)

1. Expiry of fixed term
2. Completion of adventure or undertaking
3. Death of a partner
4. Insolvency of a partner

(IV) Compulsory (Sec 41): A firm is dissolved in the following circumstances:

1. Insolvency of all partners or all except one
2. Business becoming unlawful

(V) Dissolution by the Court (Sec 44): Section 44 provides that the dissolution of a firm may take place on a suit filed by a partner on any of the following grounds, namely:

1. Insanity of a partner [Section 44(a)]
2. Permanent incapacity [Section 44(b)]
3. Misconduct [Section 44(c)]
4. Persistent breach of agreement [Section 44(d)]
5. Transfer of interest [Sec.44 (e)]
6. Continuous losses[Section 44(f)]
7. Just and equitable causes [Sec.44(g)]

Consequences of Dissolution

The consequences of dissolution are as follows:

1. Continuous liability if fails to give a public notice [Sec. 45]
2. Continuous authority of partners for purposes of winding up [Sec. 47]
3. Right to have the business wound up [Sec. 46]
4. Right to return of premium [Sec. 51]
5. Rights where partnership contract is rescinded for fraud or Misrepresentations [Sec. 52]
6. Rights to impose restrictions [Sec. 53]
7. Liability to share personal profits [Sec. 50]

Settlement of Accounts upon Dissolution

1. Treatment of goodwill
2. Meeting losses [Sec.48 (a)]
3. Order of applications of assets [Sec.58(a)]
4. Losses arising from insolvency of a partner
5. Payment of firm's debts and separate debts [Sec. 49]

Public Notice

The Partnership Act requires that a public notice must be given in each of the following cases:

1. On Minor Attaining Majority;
2. Retirement of a partner;
3. Expulsion of a partner;
4. Dissolution of the firm.

7.2 SALE OF GOODS ACT, 1930

The law defining their respective rights and obligations is contained in the Indian Sale of Goods Act, 1930. Before 1930, law relating to sale of goods was contained in the Indian Contract Act, 1872. The departures made by the Sale of Goods Act are in regard to the consideration, implied conditions and warranties etc.

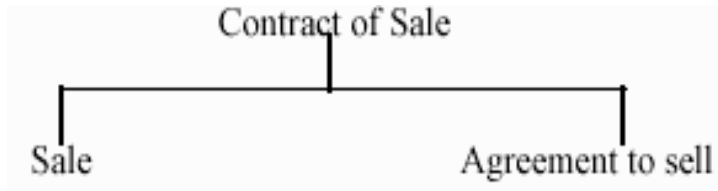
Essentials of a Contract of Sale of Goods

“A contract of sale of goods is a contract whereby the seller transfers or agrees to transfer the property in goods to the buyer for a price.” [Sec. (4) 1]. Important features of a contract of sale

1. **Two Parties**
2. **Mutual Consent:** Just the presence of two parties is not sufficient. The parties must agree on the transfer of property.
3. **Transfer of Property:** What a contract of sale stipulates is the transfer of property i.e. the ownership of the goods and not the possession of the goods.
4. **Goods:** Goods means every kind of movable property other than actionable claims and money. But it includes stock and shares, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before sale or under the contract of sale. [Sec. 2(7)]. Since the price of the goods is expressed in terms of the money, money itself cannot be bought, and hence, money is not considered as goods.
5. **Price:** Under a contract of sale, property in the goods is transferred to the buyer for a price. Price is the money consideration for the goods.
6. **Varied requirement as to delivery and payment:** The contract may provide for the immediate delivery of goods or immediate payment of the price or both.

7. **Requires no formalities**

8. **Absolute or Conditional:** An absolute contract of sale is technically called a 'sale'. Thus "where under a contract of sale the property in the goods is transferred from the seller to the buyer, the contract is called a sale." [Sec. 4 (3)]. Thus a contract of sale is a generic term including 'Sale' as well as 'an agreement to sell'.



Distinction between 'Sale' and 'Agreement to Sell'

1. **Transfer of Property:** In a sale the buyer becomes the owner immediately (i.e. as soon as the contract of sale is made). But in an agreement to sell the seller continues to be the owner unless it becomes a sale by the expiry of certain time or by the fulfillment of the conditions agreed upon.
2. **'Jus in rem' and 'Jus in Personam:** A sale creates 'Jus in rem' i.e. rights against the goods.
3. **Risk of Loss:** Risk prima facie passes with property (Sec. 26). The buyer would bear the risk of loss, even if goods are in the possession of the seller. But in case of an agreement to sell the ownership remains with the seller and as such the seller would be liable for the loss.
4. **Consequences of default:**
 - a) When the buyer commits the default and does not pay the price of the contract is a 'sale. The seller can sue for the price, even if the goods are in the possession of the seller himself. But in 'an agreement to sell he cannot sue him (buyer) for the price of the goods even if the goods happen to be in the possession of the buyer.
 - b) When the seller commits default and refuses to sell the goods or sells the goods to some other person, then if the contract is a sale the buyer can recover his goods, even from a second buyer (except under certain circumstances) and sue the seller for breach of contract as well, but in case the contract is only an 'agreement to sell 'the buyer can only sue the seller for the breach of contract but cannot recover the goods.
5. **Where the buyer becomes insolvent:** Where the contract is a 'sale' the seller would have to part with the goods and can receive in buyer's insolvency, only ratable dividend for the price due. An agreement to sell, the seller may refuse to deliver the goods to the official receiver/assignee of the buyer's property unless he is paid the full price.
6. **Insolvency of the seller:** If it is a sale, the buyer can recover it from the official receiver/assignee. But in an agreement to sell buyer cannot recover the goods even if he has paid the price in advance.

Sale Distinguished from Other Transactions

1. **Sale, Barter and Exchange:** If the goods are exchanged for goods only it is called 'barter' and not sale. If money is exchanged for money (say \$ 10 for Rs.450) it is called 'EXCHANGE' only. But where goods are exchanged for a money consideration, it is called a sale. If the consideration consists partly of money and partly of goods, it would be a contract of sale.
2. **'Hire Purchase' and 'Agreement to Sell':** In a contract of sale there is an agreement to buy but in 'hire purchase', hirer has the option to buy the goods if he pays all the installments. Hence if he does not exercise his option, the owner cannot sue for breach of contract but can take his goods back. In an agreement to sell, if the buyer refuses to buy the goods the seller can sue him for breach of contract.
3. **Sale and Contract for Work and Labour:** If the essence of the contract is the rendering of service and exercise of skill it is a contract of work and labour, though goods are also delivered under the contract. But if the delivery of goods is the essence of the contract although some labour on the part of the seller may be necessary, it would be a contract of sale.

Kinds of Goods

The goods are classified by sec 6, as follows:

1. **Existing goods:** Existing goods are those which are owned or possessed by the seller at the time of the contract of sale. Existing goods may be further classified into:
 - (i) Specific;
 - (ii) Ascertained; and
 - (iii) Unascertained.

“Specific goods mean goods identified and agreed upon at the time a contract of sale is made” [Sec. 2(14)]. Ascertained goods are those which are identified and agreed upon after a contract of sale is made. The goods which are only defined by description and not specifically identified at the time a contract of sale is made are called unascertained goods.

2. **Future Goods:** Future goods mean goods to be manufactured or produced or acquired by the seller after the making of the contract of sale.” [Sec.2(6)], Example: A agrees to sell to B the entire crop of Onion, that his land would yield, at Rs.10,000 per ton. This is a contract for the sale of future goods because goods are still to be produced.
3. **Contingent goods:** Contingent goods are those the acquisition of which by the seller depends upon a contingency which may or may not happen [Sec. 6(2)]. Example: A agrees to sell the cow to B if A inherits C's property including the cow. C donates the entire property to a trust. The contract becomes void.

Perishing of Goods

After a contract of sale is made the subject matter of the contract may be destroyed or it may be found that the subject matter had already been destroyed before the date of making the contract, the effect of the two cases would be different.

1. **Goods perishing before the contract of sale** (Sec.7) provides, “where there is a contract for the sale of specific goods the contract is void if the goods without the knowledge of the seller have, at the time when the contract was made, perished or become so damaged as no longer to answer to their description in the contract.’
2. **Goods perishing after the contract of sale is made**
 - a) **Perishing before sale but after an agreement to sell:** “unless otherwise agreed, the goods remain at the seller’s risk until the property therein is transferred to the buyer...”
 - b) **Goods perishing after sale:** In sale, goods are destroyed after sale. The loss arising from the destruction or damage of the goods would be borne by the buyer.(Sec.26)

The Price

Meaning: “Price means the money consideration for a sale of goods” [Sec. 2(10)].

How to fix the price?

1. By the contract: The price in a contract of sale may be fixed by the contract between the parties (Sec. 69).
2. In an agreement: The price may be left to be fixed in manner thereby agreed (Sec.9). Whatever manner of fixing the price has been agreed upon by the parties to the contract that would be recognized by law.
3. Valuation by third party: The price may be left to be fixed by a third party.
4. By the course of dealings: Where the price is neither expressed in the contract nor any manner of fixing the price is agreed, the price would be determined by the course of dealings between the parties.
5. Reasonable price: What is a reasonable price is question of fact depending on the circumstances of each case. Generally the market price on the date of supply is taken to be a reasonable price.

Earnest or Deposit: The money so paid is called earnest or deposit. If buyers commit a breach of the contract and seller files a suit for damages, the amount of damages shall be reduced by the amount of earnest money forfeited.

Taxes imposed after the contract of sale [Sec.64 (A)]: Any tax, is imposed or increased after making of the contract of sale of such goods, then the seller can recover the same from the buyer.

Payment of price a concurrent condition with that of delivery (Sec.32): The seller shall be ready, and willing to give possession of the goods to the buyer in exchange for

the price, and the buyer shall be ready and willing to pay the price in exchange for possession of the goods.”

Time as Essence of Contract

A contract of sale of goods may stipulate the time for the payment of the price and also the time for delivery of goods.

1. **Regarding payment:** “Unless a different intention appears from the terms of the contract, stipulations as to time of payment are not deemed to be the essence of a contract of sale.”
2. **Regarding delivery:** as regards stipulation relating to the time of delivery of goods. (Sec.11).

7.3 LAW OF INSURANCE

The contract of insurance is called an aevator contract because it depends upon an uncertain event. Lord Mansfield described insurance as “a contract on speculation.”

Fundamental Principles of Insurance:

1. Good Faith;
2. Insurable Interest;
3. Indemnity;
4. Mitigation of Loss;
5. Attachment of Risk;
6. Causa Proxima.

Good Faith: A contract of insurance is a contract, uberrimae fidei; a contract based on utmost good faith and if the utmost good faith is not observed by either party the contract may be avoided by the other.

Insurable Interest: The assured must have an actual interest called the insurable interest, in the subject-matter of the insurance; either he must own part or whole of it, or he must be in such a position that injury to it would affect him adversely.

Indemnity: Excepting life assurance and personal accident and sickness insurance, a contract of insurance contained in a fire, marine, burglary or any other policy is a contract of indemnity.

Mitigation of Loss: In the event of some mishap to insured property, the owner (the insured) must act as though he were uninsured, and make every effort to preserve his property.

Risk Must Attach: A contract of insurance can be enforced only if the risk has attached.

Causa Proxima: Make the insurer liable for loss, such loss must have been proximately caused by the peril insured against *Causa proxima non remota spectator*.

Contract of Insurance One from Year to Year

The general rule is the except in the case of life assurance a contract of insurance is a contract from year to year only.

Premium: The premium is the price for the risk undertaken by the insurer. It is the consideration for the insurance.

Days of Grace: The days of grace are the days allowed by the insurance company after the expiry of the stipulated period of insurance during which the assured can pay the premium in order to continue or to renew the policy of insurance.

Policy: The policy is a formal and enforceable stamped document signed and issued by the insurance company embodying the terms of the contract between the parties.

Interim Receipt, Certificate or Cover Note: A cover note or interim certificate is a document which the insurance company, on receiving the proposal, may issue pending the execution of a policy or the final decision of the directors as to acceptance or rejection of the proposal.

Re-Insurance: Re-insurance is a contract which insures the thing originally insured, and by which an insurer is to be indemnified against any loss which he may sustain by reason of being himself compelled to pay the assured under the original contract of insurance.

Double Insurance: When the same subject-matter is insured with two or more insurers and the total sum insured exceeds the actual value of the subject matter, it is known as double insurance and it amounts to over-insurance.

Subrogation: The right of subrogation is a necessary corollary of the principle of indemnity and is essential for its preservation.

Contribution: Contribution is the right of the insurers to claim from others some payment towards the loss, and arises only where there is double insurance.

Marine Insurance

The law relating to marine insurance is found in the Marine Insurance Act, 1963. A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the assured, in the manner and to the extent thereby agreed, against marine

losses, that is to say, the losses incidental to marine adventure (Sec.3). There is a marine adventure when –

1. Any insurable property is exposed to maritime perils;
2. The earnings or acquisition of any freight, passage money, commission, profit or other pecuniary benefit, or the security for any advances, loans, or disbursements is endangered by the exposure of insurable property to maritime perils;
3. Any liability to third party may be insured by the owner of, or other person interested in or responsible for, insurable property by reason of maritime perils [Sec. 2(e)].

Maritime Perils: It means the perils consequent on, or incidental to, the navigation of the sea, that is to say, perils of the seas, fire, war perils, pirates, rovers, thieves, captures, seizures, restraints and detentions of princes and peoples, jettisons, barratry and any other perils which are either of the like kind or may be designed by the policy [Sec. 2(e)].

Types of Policies

Voyage Policy: Where the contract is to insure the subject-matter “at and from” or from one place to another or others, the policy is called a voyage policy.

Time Policy: Where the contract is to insure the subject-matter for a definite period of time, the policy is called a time policy.

Valued Policy: A valued policy is a policy which specifies the agreed value of the subject-matter insured.

Unvalued Policy: An unvalued policy is a policy which does not specify the value of the matter insured, but subject to the limit of the sum insured, leaves the insurable value to be subsequently ascertained (Sec. 30).

Floating Policy: A floating policy is a policy which describes the insurance in general terms, and leaves the name or names of the ship or ships and other particulars to be defined by subsequent declaration.

Wager or Honour Policy: It is a policy in which the assured has no insurable interest or the insurer or underwriter is willing to dispense with the proof of interest.

Insurable Interest

The person who effects insurance, or issues instructions for effecting it, must have an insurable interest in the subject-matter. **The assured must have insurable interest at the time of the loss though he may not have been interested when the insurance was actually effected.**

Insurable Value:

Insurable value is the amount of the valuation of the insurable interest for the purpose of insurance.

Disclosure and Representation:

The assured must disclose to the insurer every material circumstance which is known to him, and he is deemed to know everything which he ought to know in the ordinary course of business.

Warranties: A warranty, according to sec. 35 of the Act, is an undertaking by the assured that some condition shall be fulfilled, or that a certain thing shall be or shall not be done, or whereby he confirms or negatives the existence of a particular state of facts. A warranty may be express or implied. An express warranty is a condition which is set forth in the policy or attached thereto; and an implied warranty is an essential condition implied by law, though not written in the policy.

Sea-Worthiness: The ship must be sea-worthy at the commencement of the voyage, or if the voyage is divisible into distinct stages, at the commencement of each stage.

Legality: So far as the assured can control the matter, the adventure shall be carried out in a lawful manner.

The Voyage: The subject-matter may be insured by a voyage policy “from a port” or “at and from” a port.

Perils: Perils are the risks which the underwriter agrees to take upon him, and are inserted in the policy. Perils of the sea are all perils, losses, misfortunes of a marine character or a character incident to a ship as such. **The purpose of the policy is to secure an indemnity against accidents which may happen, not against events which must happen.**

Losses**Kinds of Losses:**

A loss may be either total or partial. Total loss may be subdivided into two classes: (i) Actual Total Loss, and (ii) Constructive Total Loss. The case of partial loss arises when the subject-matter of the insurance is partially lost. Partial loss is also of two classes: (i) Particular Average, and (ii) General Average.

Fire Insurance:

Fire insurance is a contract to indemnify the insured for destruction of or damage to property caused by fire.

Average Clause:

It is becoming very common in policies of fire insurance to insert a condition called the average clause, by which the insured is called upon to bear a portion of the loss himself. This condition is called the pro rata condition of average. **Insurable interest, the**

insured must have insurable interest in the subject-matter both at the time of affecting the policy and at the time of the loss.

The Risk:

The risk in fire policy commences from the moment the cover note, or the deposit receipt, or the interim protection is issued and continues for the term covered by the contract of insurance.

What is Fire?

The word fire as used in the expression “loss by fire” is to be construed in its popular and literal sense, and means a fire which has broken bounds.

Assignment:

In English law policy of fire insurance can be assigned only with the consent of the insurer.

Fire Policies

Valued Policy: In the “valued policy” the insured can recover a fixed amount, agreed at the issue of the policy without the necessity for any further proof of value at the time of the fire.

Re-Instatement or Replacement Policy: A clause is inserted in the policy under which the insured can recover not the value of buildings or plant as depreciated, but the cost of replacement of the property destroyed by new property of the same kind, or the insurers may themselves reinstate the property instead of paying in cash.

Consequential Loss Policy: The insured is indemnified for the loss of profits which he sustains through interruption or cessation of his business as a result of fire.

Life Insurance

Life assurance may be defined as a contract in which the insurer, in consideration of a certain premium, either in a lump sum or by other periodical payments, agrees to pay to the assured, or to the person for whose benefit the policy is taken, a stated sum of money on the happening of a particular event contingent on the duration of human life.

Life Insurance is Not a Contract Of Indemnity:

“The contract commonly called life assurance when properly considered is a mere contract to pay a certain sum of money on the death of a person, in consideration of the due payment of a certain annuity for his life.... This species of insurance in no way resembles a contract of indemnity.”

Insurable Interest:

The assured must have at the time of the contract an insurable interest in the life upon which the insurance is effected.

Person in His Own Life:

A person is presumed to have an interest in his own life and every part of it, and can insure for any sum whatsoever, and as often as he pleases.

Relatives:

A wife has an insurable interest in the life of her husband, and vice versa.

Persons not Related:

A creditor has an insurable interest in the life of his debtor to the extent of the debt.

Policies

Whole Life Policy: It matures only at the death whenever it may occur.

Endowment Policy: in which the sum insured is payable after the expiration of certain term of years if the policy-holder is alive, or at his death if he dies previously.

Joint Life Policies: These are issued under which the sum assured is payable at the death of the first of the two lives.

Survivorship Policy: It is also granted under which the sum assured is payable at the death of the last or survivor of two lives.

Surrender Value: The amount which the insurers are prepared to pay in total discharge of the contract, in case the assured wishes to surrender his policy and extinguish his claim upon it.

Loans on Policies: Where a policy has a surrender value, it also has a loan value, and assurance companies usually lend 95 per cent of the surrender value.

Paid-Up Policy Value: The amount to which the sum assured would be reduced at any time if the assured requested a rearrangement of his contract so that no further premium should be payable.

Principle of Good Faith and Sec.45 of Insurance Act: The general rule is that in all kinds of insurance the assured must disclose everything which is likely to affect the judgment of the insurer and what is stated must be truthful.

Accident Insurance: An injury is accidental where it is the natural consequence of an unexpected cause, or the unexpected consequence of a natural cause. Accident insurance consists of three categories:-

- a) Personal accident insurance, of three, including insurance against sickness;
- b) Property insurance, including burglary, fidelity, insolvency, etc
- c) Liability insurance, including motor insurance, workmen's compensation insurance, etc.

7.4 THE NEGOTIABLE INSTRUMENTS ACT, 1881

The law relating to negotiable instruments is primarily contained in the Negotiable Instruments Act, 1881. The word 'negotiable' means transferable from one person to another and the term 'instrument' means 'any written document by which a right is created in favor of some person.' Thus, the negotiable instrument is a document by which rights vested in person can be transferred to another person in accordance with the provisions of the Negotiable Instruments Act, 1881. The Negotiable Instruments Act does not affect the provisions of Sections 31 and 32 of the Reserve Bank of India Act, 1934. But, the following is **Not Promissory Notes**. Example: "I promise to pay B Rs. 500 and all other sums which shall be due to him."

Essentials or Characteristics of a Promissory Note:

1. In writing.
2. Promise to pay.
3. Unconditional.
4. Signed by the Maker.
5. Certain Parties.
6. Certain sum of money.
7. Promise to pay money only.
8. Number, place, date etc.
9. It may be payable in installments
10. It may be payable on demand or after a definite period
11. It cannot be made payable to bearer on demand or even payable to bearer after a certain period (Sec. 31 of RBI Act).
12. It must be duly stamped under the Indian Stamp Act

Bill of Exchange

A 'bill of exchange' is defined by Section 5 as "an instrument' in writing, containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to or the order of, a certain person, or to the bearer of the instrument."

Characteristic features of a Bill of Exchange:

1. It must be in writing.
2. It must contain an order to pay and not a promise or request. Words, like 'Please pay Rs. 10,000 to A, on demand and oblige, do not constitute the instrument a bill of exchange.
3. The order must be unconditional.
4. There must be three parties, viz., drawer, drawee and payee.
5. The parties must be certain.
6. It must be signed by the drawer.
7. The sum payable must be certain or capable of being made certain.

8. The order must be to pay money and money alone.
9. It must be duly stamped as per the Indian Stamp Act.
10. Number, date and place are not essential. Oral evidence may be obtained as to date and place of execution.

Cheque

A cheque is defined as ‘a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand’ (Section 6). Thus, a cheque is a bill of exchange with two added features, viz.:

- a) It is always drawn on a specified banker; and
- b) It is always payable on demand and not otherwise.

DISTINCTION BETWEEN PROMISSORY NOTE AND BILL OF EXCHANGE

Promissory note differs from a bill of exchange in the following respects:

	Promissory Note		Bill of Exchange
1.	There are only two parties-the maker (debtor) and the payee (creditor).	1.	There are three parties-the drawer, the drawee and the payee.
2.	Contains an unconditional promise by the maker to pay the payee.	2.	Contains an unconditional order to the drawee to pay according to the drawer’s directions.
3.	No prior acceptance is needed.	3.	A bill payable ‘after sight’ must be accepted by the drawee or his agent before it is presented for payment.
4.	The liability of the maker or drawer is primary and absolute.	4.	The liability of the drawer is secondary and conditional upon non-payment by the drawee.
5.	No notice of dishonour need be given.	5.	Notice of dishonour must be given by the holder to the drawer and the intermediate endorsers to hold them liable thereon.

DIFFERENCE BETWEEN BILL OF EXCHANGE AND CHEQUE:

	Cheque		Bill of Exchange
1.	Must be drawn only on a banker.	1.	Can be drawn on any person including a banker.
2.	The amount is always payable on demand.	2.	The amount may be payable on demand or after a specified time.
3.	The cheque is not entitled to days of grace.	3.	A usance (time) bill is entitled to three days of grace.
4.	Acceptance is not needed.	4.	A bill payable after sight must be accepted.
5.	A cheque can be crossed	5.	Crossing of a bill of exchange is not possible.
6.	Notice of dishonour is not necessary. (The parties thereon remain liable, even if no notice of dishonour is given.)	6.	Notice of dishonour is necessary to hold the parties liable thereon. (A party who does not receive a notice of dishonour can generally escape its liability thereon.)
7.	Not to be noted or protested in case of dishonour.	7.	Noted or protested to establish dishonour.
8.	The protection given to the paying banker in respect of crossed cheques is peculiar to this instrument.	8.	No such protection is available in the case of bills.

Holder and Holder-In –Due-Course

According to section 8, a **holder** of a negotiable instrument is “a person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto.” Thus, a person who has obtained the possession of an instrument by theft or under a forged endorsement is not a holder as is not entitled to recover the amount of the instrument.

A **‘holder in-due-course’** is “a person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or endorsee thereof, if payable to order, before the amount mentioned in it becomes payable and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title (Section 9).

Privileges of a Holder in Due Course

1. A person, who signed and delivered to another a stamped but otherwise inchoate (incomplete) instrument, is stopped from asserting, as against a holder in due course.
2. The maker or drawer, the acceptor, and all the intermediate endorsers continue to remain liable to the holder in due course until the instrument is duly satisfied.
3. Where a bill of exchange is drawn by a fictitious person and is payable to his order, the acceptor cannot be relieved from his liability to the holder in due course.
4. Where an instrument is negotiated to a holder in due course, the parties to the instrument cannot escape liability on the ground that the delivery of the instrument was conditional or for a special purpose only (Sections 46 & 47).
5. Not only that the title of the holder in due course is not subject to the defect in previous holder's title but once the instrument passes through the hands of a holder in due course, it is purged of all defects.
6. No maker of a promissory note and no drawer of a bill of exchange or cheque shall in a suit thereon by a holder in due course, be permitted to deny the validity of the instrument as originally made or drawn.
7. No maker of a note and no acceptor of a bill payable to order is, in a suit thereon by a holder in due course, permitted to deny the payee's capacity at the date of the note or bill to endorse it (Section 121).

Ambiguous Instrument (Sec.17): An ambiguous instrument is one which may be construed either as a promissory note or as a bill exchange. The holder may at his option treat it as either and the instrument shall be treated accordingly.

Where Amount is stated differently in Figures and Words (Sec. 18): If the amount undertaken or ordered to be paid is stated differently in figures and in words, the amount stated in words shall be the amount undertaken or ordered to be paid.

Inchoate Instruments (Sec.20): An inchoate instrument means an instrument that is incomplete in certain respects. The person so signing shall be liable upon the instrument, in the capacity in which he signed the same, to any holder-in due course for such amount. But, a person other than a holder-in-due course cannot recover from the person delivering the instrument anything in excess of the amount intended by him to be paid there under.

Minor (Sec. 26): A minor may draw, indorse, deliver and negotiate negotiable instruments so as to bind all parties except himself.

Agency (Sec. 27): Every person capable of binding himself or of being bound may so bind himself or be bound by a duly authorized agent acting in his name.

Liability of Agent Signing (Sec. 28): An agent who signs his name to a P/N, B/E or cheque without indicating thereon that he does not intend thereby to incur personal

responsibility, is liable personally on the instrument, except to those who induced him to sign upon the belief that the principal only would be held liable.

Liability of Legal Representative (Sec.29): A legal representative of a deceased person who signs his name to a promissory note, bill of exchange or cheque is liable thereon, unless he expressly limits his liability to the extent of the assets received by him as such.

Negotiable Instruments Made, etc.: Without Consideration (Sec.43): A negotiable instrument made, drawn, accepted, indorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction.

Partial Absence or Failure of Money Consideration (Sec.44): When the consideration for which a person signed a promissory note, bill of exchange or cheque consisted of money, and was originally absent in part or has subsequently failed in part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionately reduced.

Partial Failure of Consideration not Consisting of Money (Sec. 45): When a part of the consideration for which a person signed a promissory note, bill of exchange or cheque, though not consisting of money, is ascertainable in money without collateral enquiry, and there has been a failure of that part, the sum which a holder standing in immediate relation with such signer is entitled to receive from him is proportionally reduced.

Lost or Stolen Instruments [Sec. 58]: When a negotiable instrument has been lost, or has been obtained from any maker, acceptor or holder thereof by means of an offence or fraud, or for an unlawful consideration, no possessor or indorsee who claims through the person who found or so obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor or holder, or from any party prior to such holder. However, if such possessor or indorsee is a holder in due course he shall be entitled to receive the payment thereof.

Lost Instruments: When a bill or note is lost, the finder acquires no title to it as against the rightful owner. He is also not entitled to sue the acceptor or maker in order to enforce payment on it. If the finder obtains payment, the person who pays it in due course may be able to get a valid discharge for it. But the true owner can recover the money due on the instrument from the finder.

Stolen Instruments:

1. A person cannot enforce payment of it against any party thereto nor can he retain it against the party from whom he had stolen it.
2. If the thief negotiates the instrument to a purchaser for value who has notice of the theft, the transferee cannot acquire a better title than the thief and thus cannot enforce payment.

3. If a person who has stolen a bill or note payable to bearer transfers it to a holder in due course, he confers a good title on him or any person deriving title from such holder.

Instruments Obtained for Unlawful Consideration

1. The instrument is void.
2. A holder in due course, however, obtains a good title to an instrument which was originally made or drawn or subsequently negotiated for an unlawful consideration.

Forged Instruments: The most common species of forgery is fraudulently writing the name of an existing person. It is also a forgery to sign the name of a fictitious person or non-existing person. Even a man's signature of his own name may amount to forgery, if it is put with the intention that the signature should pass for the signature of another person of the same name.

Legal Position:

1. A forged signature is worthless and confers no title.
2. The holder of a forged instrument cannot enforce payment thereon nor can he give a valid discharge therefore.
3. The true owner can compel the debtor to pay it over again to him.
4. Even a holder in due course cannot claim payment on a forged instrument.
5. A person whose signatures have been forged may, by his conduct, be stopped from denying its genuineness to an innocent holder.

CHEQUE

A cheque is the usual method of withdrawing money from an account with a banker. A cheque, in essence, is an order by the customer of the bank directing his banker to pay on demand, the specified amount, to or to the order of the person named therein or to the bearer. Section 6 defines a cheque as "bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand."

Requisites of a Cheque:

1. **Written Instrument.** A cheque must be an instrument in writing.
2. **Unconditional Order.** A cheque must contain an unconditional order.
3. **On a Specified Banker Only.** A cheque must be drawn on a specified banker.
4. **A Certain Sum of Money.** The order must be only for the payment of money and that too must be specified.
5. **Payee to be certain.** A cheque to be valid must be payable to a certain person.
6. **Payable on Demand.** A cheque to be valid must be payable on demand and not otherwise.
7. **Amount of the Cheque.** A mount of the cheque must be clearly mentioned.
8. **Dating of Cheques.** The drawer of a cheque is expected to date it before it leaves his hands.

A cheque bearing an earlier date is **ante-dated** and the one bearing the later date is called **post-dated**. In India, a cheque that bears a date earlier than six months is a **stale cheque** and cannot be claimed for. In England, cheque can remain in circulation for a period of twelve months.

Crossing of Cheques: Crossing of a cheque is a direction to the paying banker by the drawer that payment should not be made across the counter. The payment on a crossed cheque can be collected only through a banker. Section 123, defines crossing as, “Where a cheque bears across its face an addition of the words ‘and company’ or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words ‘not negotiable’, that addition shall be deemed a crossing and the cheque shall be deemed to be crossed generally. A cheque having the cross mark such as ‘X’ is not generally regarded as a crossed cheque. A cheque that is not crossed is called an open cheque.

Significance of Crossing: Payment cannot be claimed across the counter on a crossed cheque, crossing of cheques serves as a measure of safety against theft or loss of cheques in transit. By crossing a cheque, a person, who is not entitled to receive its payment, is prevented from getting the cheque encashed at the counter of the paying banker.

Types of Crossing:

Crossing may be either (1) General or (2) Special.

General Crossing: The term general crossing implies the addition of two parallel transverse lines.

Special Crossing: ‘Special Crossing’ implies the specification of the name of the banker on the face of the cheque. Section 124 in this regard, reads: Where a cheque bears across its face, an addition of the name of a bank, either with or without the words ‘not negotiable’, that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed to that banker.” The object of special crossing is to direct the drawee banker to pay the cheque only if it is presented through the particular bank mentioned therein. Thus, it makes the cheque system still safer.

Not Negotiable Crossing: By including the words ‘not negotiable’, the cheque is deprived of its special feature of negotiability. Such a cheque is like any other goods where the title of the transferee is always subject to the title of the transferor. A bank, therefore, should be extra careful in paying such cheques.

Account Payee Crossing (A/c Payee Crossing): An A/c payee crossing signifies that the drawer intends the payment to be credited only to the payee’s account and in none else. The addition of ‘A/c payee’ to a crossing has no legal sanctity and the paying banker may ignore such a direction without being liable for any damages.

Not Negotiable, A/c Payee Crossing: The instrument is rendered not negotiable plus A/c payee crossing directs the collecting banker to collect it for the payee only and warns that if the amount is collected for someone else, he may be held liable for damages.

Who can Cross a Cheque?

1. The drawer of a cheque.
2. The holder of a cheque
3. The Banker.

A cheque once crossed need not remain so forever. The drawer has the right to cancel the crossing by writing the words 'pay cash' and putting his 'full signatures'.

Marking of Cheques: Marking or certification is a method adopted when the paying banker verifies the customer's account and indicates thereon that there are enough funds in his Account to meet that cheque. The marking of a cheque may be done at the instance of the **drawer** or at the instance of the **payee** or at the instance of the **collecting banker**. The effect of marking is different in the three cases.

Marking at the Instance of the Drawer: The banker acquires a right to retain money to meet such a cheque. Marking only certifies the genuineness of the drawer's signature and the sufficiency of funds and not the endorsements.

Marking at the Request of the Payee or Holder: It constitutes nothing more than intimation that at the time of marking, the bank has a sufficient balance to the credit of the drawer.

Marking between Bankers: This marking is an appropriation of funds in the banker's hands for a specific purpose he is entitled to deduct the amount of such marked cheque when estimating the balance available for meeting other cheques.

Marking of Post-dated Cheques: It has been held anomalous and invalid. Marking of such a cheque amounts to a promise, requiring consideration to support it.

Material Alterations

A material alteration was defined as "an alteration which alters the business effect of the instrument if used for any business purpose. Any change made in the instrument that causes it to speak a different language from what is originally intended, or which changes the legal identity of the instrument in its terms or in relation or parties thereto is a material alteration."

Examples of material alteration are: (i) date (ii) the time of payment (iii) the place of payment (iv) the sum payable (v) the number of parties (vi) the relationship between parties (vii) legal character of the cheque (viii) opening a crossed cheque (ix) converting an order cheque into a bearer cheque.

Effect of Material Alteration (Section 87): It renders the same void as against any one who is party thereto at the time of making such alteration and does not consent thereto unless it was made in order to carry out the common interest of the original parties, and any such alteration, if made by an endorsee, discharges his endorsers from all liability to him in respect of the consideration thereof.”

Examples of Alterations Which are not Material: (i) filling blanks of the instrument (Section 20); (ii) conversion of blank endorsement into endorsement in full (Section 49); (iii) crossing of cheques (Section 125);

Forgery

No protection is granted to paying banker for making payment of cheques bearing forged signature of the customer. Payment of a cheque bearing forged signature of the customer is deemed to be a payment without the authority of customer and hence constituted breach of the implied contract between banker and the customer.

The Paying Banker:

The ‘paying banker’ is a term used to denote the position and duties of the drawee banks in payment the cheques of their customers. Thus, ‘paying banker’ is a banker upon whom a cheque is drawn. The job of a paying banker in regard to the payment of cheques is highly risky. However, this obligation of the paying banker to honour his customer’s cheque is subject to certain conditions:

Statutory Protection Available to a Paying-Banker: Section 31 holds the paying banker liable for payment to a wrong person. But, the banker, despite his efforts, may inadvertently happen to pay a cheque to a wrong person claiming payment under a clever **forgery of endorsement.**

Payment in Due Course (Section 10)

The following conditions must be satisfied before a payment of negotiable instrument can be called as a payment in due course

1. Payment must be in accordance with the apparent tenor of the instrument.
2. Payment must be made in good faith and without negligence.
3. Payment must be made to the person in possession of the instrument.
4. Payment must be made under circumstances which do not afford a reasonable ground for believing that he is not entitled to receive payment of the amount mentioned therein.
5. Payment must be made in money only.

When Must Banker Refuse Payment?

1. Where the customer countermands the payment: A banker must refuse to honour cheque, payment for which has been stopped by the drawer.
2. On receipt of a notice of customer’s death
3. On customer’s becoming insolvent

4. On receipt of a notice of the customer's insanity
5. On receipt of Garnishee order: Where Garnishee Order is absolute, i.e., attaching the whole amount, payment on cheques received after the receipt of such an order must be refused.
6. On assignment of Credit balance: On receipt of a notice of assignment signed by the customer of credit balance of his account.
7. On suspicious misuse by trustee: If the banker feels suspicious, that the trustee intends to use the amount of the cheque for his personal use.
8. On suspicious as to the title: Where the banker believes that the person presenting the cheque is not entitled to receive the payment thereon.
9. In case of a joint account to be operated by all jointly where the cheque is not signed by all of the joint account holders.
10. Where the cheque is irregular, ambiguous or otherwise materially altered.
11. Where the cheque is presented after a period of six months from the date it bears, i.e., it has become stale.

When May Banker Refuse Payment?

In the following cases the banker may dishonour a cheque without incurring any liability thereon:

1. Where the cheque is post-dated: Refusal to pay a post-dated cheque before its due date does not make a banker liable for wrongful dishonour.
2. Where the funds of the customer are insufficient.
3. Where a cheque is not duly presented. (For instance, a cheque presented after business hours).

Negotiation

A negotiable instrument may be transferred by negotiation or assignment. When a negotiable instrument is transferred by negotiation, its transferee, if holder in due course, gets a better title than its transferor.

Negotiation By Mere Delivery: (Section 47) A bill or cheque payable to bearer is negotiated by mere delivery of the instrument. Delivery may be actual or constructive. Actual delivery means change of actual possession. It is a constructive delivery when the possession is given to the transferee's agent, clerk or servant on his behalf.

Payable to Bearer: An instrument is payable to bearer (1) where it is made so payable, or (2) where it is originally made payable to order but the only or the last endorsement is in blank. A cheque which is originally drawn payable to bearer remains bearer even though it is subsequently endorsed in full. The rule is **once a bearer cheque always a bearer cheque** or (3) where the payee is a fictitious person.

Negotiation By Endorsement and Delivery: Instruments payable to a specified person or to the order of a specified person can be negotiated only by endorsement and delivery.

Endorsement/ Indorsement

1. It must be written on the instrument itself and be signed by the indorser.
2. The endorsement must be of the entire instrument.
3. Where in a negotiable instrument payable to order, the payee or endorsee is wrongly designated or his name is mis-spelt, he should sign the instrument in the same manner as given in the instrument.
4. Where there are two or more endorsements on an instrument, each endorsement is deemed to have been made in the order in which it appears on the instrument, until contrary is proved.
5. An endorsement may be blank or full. It may also be restrictive.

Kinds of Endorsements:

According to the Negotiable Instruments Act, 1881, endorsement may take any of the following forms:

1. **Conditional Endorsement:** It is one which makes the transfer of the property in a negotiable instrument from the endorser to the endorsee dependent upon the fulfillment of a stated condition. For example, where the endorsement states “Pay ‘X’ if he reaches Delhi”. In such a case, ‘X’ can claim payment on the instrument only if he reaches Delhi.
2. **Endorsement in Blank:** Where the endorser just puts his signature without specifying the endorsee, the endorsement is said to be in blank (Section 16). For example, a cheque is payable to ‘X or order’ and ‘X’ merely signs on the back of it, will constitute endorsement in blank.
3. **Endorsement in Full:** Where along endorser’s signature, the name of the endorsee is specified, the endorsement is called ‘endorsement in full’ (Section 16). “Pay Y or order” and is signed by ‘X’, the payee, it constitute ‘endorsement in full.’
4. **Restrictive Endorsement:** An endorsement is restrictive which prohibits the further negotiation of a negotiable instrument.
5. **Endorsement ‘Sans Recourse’:** An endorsement of a negotiable instrument may be express words in the endorsement exclude his own liability thereon (Section 52). Such endorsement is called ‘Endorsement Sans recourse’ or ‘without recourse to me’. For example, where X endorse a cheque as: ‘Pay Y or order Sans Recourse’ or ‘Pay Y or order without Recourse to me’. ‘X’ will not be liable on the instrument if it is dishonoured.
6. **Sans Frais:** Indicates that no expenses should be incurred on account of the bill.
7. **Facultative Endorsement:** The endorser waives his right to receive notice of dishonour.
8. **Partial Endorsement:** Where the negotiable instrument is endorsed for part of the amount. Such an endorsement is not valid.

Effect of Endorsement: The effect of an endorsement in blank and delivery of an instrument originally made, drawn, payable to order is to convert it into one payable to bearer and transferable by mere delivery. The effect of restrictive endorsement is

- a) to prohibit or exclude further negotiation, or
- b) to constitute the endorsee an agent of endorser to endorse the instrument, or
- c) to constitute the endorsee as agent to receive its contents for some other specified persons.

THE COLLECTING BANKER: One of the principal functions of a banker is to receive instruments from his customer in order to collect the proceeds and credit them to his customer's account. When acting in this capacity he is called a "collecting banker".

Statutory Protection to a Collecting Banker

1. For Crossed Cheques only.
2. Collection for customers.
3. Acted in Good Faith and Without Negligence.

Bill of Exchange and Promissory Note Kinds of Bills

1. **Inland Bill:** "a promissory note, bill of exchange or cheque drawn or made in India and payable in or drawn upon any person resident in India". (Section 11).
2. **Foreign Bills:** According to Section 12, a foreign bill is negotiable instrument which is not an inland instrument.
3. **Trade and Accommodation Bills:** A trade bill is a bill of exchange issued in respect of a genuine trade transaction. Such bills are drawn by the seller on the buyer in respect of payment of the price of the goods sold and purchased.
4. **Time Bills (Usance Bills):** Time bills, also called as usance bills, are bills payable at a fixed period after date or sight of the bills.
5. **Demand Bills:** A bill of exchange or a promissory note is payable on demand when –
 - a) It is made payable 'on demand' or 'at sight' or 'on presentation' (Section 21)
 - b) No time for payment is mentioned therein (Section 19).
6. **Clean and Documentary Bill:** Where the banker is instructed to deliver to the drawee of the bill the documents of title against acceptance of the bill, the bill is called as Documents against Acceptance of Bill (**D/A Bill**) and where the documents are to be released only against payment, it is called as Documents against Payment of Bill (**D/P Bill**).

Parties to a Bill of Exchange

1. The Drawer
2. The Drawee
3. The Payee

4. The Holder
5. The Indorser
6. The Indorsee

Drawee in Case of Need: Such a person whose name is mentioned as an alternative drawee is called a drawee in case of need'.

Acceptor for Honour: An acceptor for honour is a person who, on the refuse by the original drawee to accept the bill or to furnish better security when demanded by the notary, accepts the bill in order to safeguard the honour of the drawer or any indorser.

Parties to a Promissory Note

1. The Maker
2. The Payee
3. The Holder
4. The Indorser
5. The Indorsee

Capacity of Parties: The capacity of a party to draw, accept, make or endorse a bill or note is co-extensive with his capacity to enter into contract.

Acceptance: The acceptance of a bill is the indication by the drawee of his assent to the order of the drawer. An acceptance of a bill may be **general** or **qualified**.

Presentment: Presentment of a negotiable instrument is made for two purposes.

(1) For acceptance, and (2) For payment.

Dishonour:

A bill of exchange may be dishonoured either by non-acceptance or by non-payment.

Dishonour by Non-Acceptance: Section 91 enumerates the circumstances when a bill will be considered as dishonoured by non-acceptance.

Dishonour by Non-Payment: A negotiable instrument is said to be dishonoured by non-payment when the maker, acceptor or drawee, as the case may default in payment upon being duly required to pay the same (Section 92).

Compensation:

Section 117 lays down rules for determining the amount of compensation to the holder or an endorser in the event of dishonour of a negotiable instrument, which includes: **Compensation to holder, Compensation to Endorse, Compensation against Banker,**

Discharge of One or More Parties.

One or more parties to a negotiable instrument is/are discharged from liability in the following ways:

1. **By cancellation** [Sec. 82 (a)].
2. **By release** [Sec. 82 (b)].
3. **By payment** [Sec. 82 (c) and 8]
4. **By allowing drawee more than 48 hours to accept** (Sec.83)
5. **By taking qualified acceptance** (Sec. 86).
6. **By not giving notice of dishonour.**
7. **By non-presentment for acceptance of a bill** (Sec.61)
8. **By delay in presenting cheque** (Sec.84).
9. **By material alteration.**
10. **By negotiation back.**

7.5 REVIEW QUESTIONS

1. What are the legal consequences if the goods are not delivered in time and the payment is not made in time?
2. What are the fundamental principles of Insurance? Explain the losses in life Insurance.
3. What do you mean by crossing a cheque? What are the circumstances in which a banker is entitled to dishonour a cheque?
4. What is Agency by 'Ratification'? What are the essential conditions to make a valid ratification?
5. Enumerate the rights and obligations of finder of lost goods.
6. Explain and illustrate the circumstances under which contracts need not be performed.

COMPANY LAW PART – I

Structure

8.1 Nature of Company and Formation

8.2 Memorandum and Article of Association

8.3 Prospectus

8.4 Statement In Lieu of Prospectus

8.5 Share and Share Capital

8.1 NATURE OF COMPANY AND FORMATION

The Companies Act, 1956 defines the word ‘company’ as a company formed and registered under the Act or an existing company formed and registered under any of the previous company laws (Section 3). Section 12 permits the formation of different types of companies. These may be

- a) Companies limited by shares,
- b) Companies limited by guarantee, and
- c) Unlimited companies.

The vast majority of companies in India are with limited liability by shares. The common stock so contributed is denoted in money and is “the capital” of the company. The persons who contribute it, or to whom it belongs, are members. The proportion of capital to which each member is entitled is his “share”. Shares in a company are transferable.

Features of the Company: The following are the characteristic features of company:

1. **Incorporated Association:** A company must be incorporated or registered under the Companies Act. Minimum number required for the purpose is 7 in case of a public company, and 2, in case of a private company (Sec. 12). As per Section 11, an association of more than 10 persons, in case of banking business, and 20 in case of any other business, if not registered as a company under the Companies Act, or under any other law for the time being in force, becomes an illegal association.
2. **Artificial Person:** A company is created with the sanction of law and is not itself a human being, it is, therefore, called artificial; and since it is clothed with certain

- rights and obligations, it is called a person. A company is accordingly an artificial person.
3. **Separate Legal Entity:** Unlike partnership, company is distinct from the persons who constitute it. Section 34(2) says that on registration, the association of persons becomes a body corporate by the name contained in the memorandum. [**Saloman v. Saloman & Co. Ltd.** (1877)]
 4. **Limited Liability:** The company being a separate person, its members are not as such liable for its debts. Hence, in the case of a company limited by shares, the liability of members is limited to the nominal value of shares held by them. Thus, if the shares are fully paid up, their liability will be nil. However, companies may be formed with unlimited liability of members or members may guarantee a particular amount. In such cases, liability of the members shall not be limited to the nominal or face value of the shares held by them. In case of unlimited liability companies, members shall continue to be liable till each paisa has been paid off. In case of companies limited by guarantee, the liability of each member shall be determined by the guarantee amount, i.e., he shall be liable to contribute up to the amount guaranteed by him.
 5. **Separate Property:** Shareholders are not, in the eyes of the law, part owners of the undertaking. In India, this principle of separate property was best laid down by the Supreme Court in *Bacha F. Guzdar V. the Commissioner of Income Tax, Bombay* (Supara). The Supreme Court held that a shareholder is not the part owner of the company or its property, he is only given certain rights by law, e.g., to vote or attend meetings, to receive dividends.
 6. **Transferability of Shares:** Since business is separate from its members in a company form of organization, it facilitates the transfer of members' interests. The shares of a company are transferable in the manner provided in the Articles of the company (Sec. 82). However, in a private company, certain restrictions are placed on such transfer of shares but the right to transfer is not taken away absolutely.
 7. **Perpetual Existence:** A company being an artificial person cannot be incapacitated by illness and it does not have an allotted span of life. The death, insolvency or retirement of its members leaves the company unaffected. Members may come and go but the company can go for ever.
 8. **Common Seal:** A company being an artificial person is not bestowed with a body of natural being. Therefore, it has to work through its directors, officers and other employees. But, it can be held bound by only those documents which bear its signatures. Common seal is the official signature of a company.
 9. **Company may sue and be sued in its own name:** Another fall-out of separate legal entity is that the company, if aggrieved by some wrong done to it may sue or be sued in its own name.

Lifting of the Corporate Veil

In case of a dishonest and fraudulent use of the facility of incorporation, the law lifts the corporate veil and identifies the persons (members) who are behind the scene and are responsible for the perpetration of fraud. The concept of lifting the corporate veil is a

changing concept. The veil of corporate personality, even though not lifted sometimes, is becoming more and more transparent in modern jurisprudence. The following are some such cases:

- (i) For the protection of revenue;
- (ii) Where the company is acting as agent of the shareholders;
- (iii) Where a company has been formed by certain persons to avoid their own valid contractual obligation;
- (iv) Where a company has been formed for some fraudulent purpose or is a “sham”;
- (v) Where a company formed is against public interest or public policy,;
- (vi) Where the holding company holds 100 per cent shares in a subsidiary company and the latter is created only for purposes of holding company;
- (vii) Where the number of members falls below statutory minimum (Section 45);
- (viii) Where prospectus includes a fraudulent misrepresentation;
- (ix) Where a negotiable instrument is signed by an officer of a company [Section 147 (4)(c)];
- (x) Holding and Subsidiary Companies (Sec. 212-213);
- (xi) Investigation into related companies (Sec. 239);
- (xii) For investigation of ownership of a company (Sec 247);
- (xiii) Where in the course of winding of a company (Sec. 542);
- (xiv) Where breach of economic offence is involved. (xv) Where company is used as medium to avoid welfare legislation;
- (xv) Where device of incorporation is used for some illegal or improper purpose;
- (xvi) To Punish for contempt of Court;
- (xvii) For determination of technical competence of company;
- (xviii) Where company is a mere sham or cloak.

Illegal Association: (Section 11)

No company, association or partnership consisting of more than 10 persons for the purpose of carrying on the business of banking and more than 20 persons for the purpose of carrying on any other business can be formed unless it is registered under the Companies Act or is formed in pursuance of some other Indian Law. Thus, if such an association is formed and not registered under the Companies Act, it will be regarded as an ‘Illegal association’ although none of the objects for which it may have been formed is illegal. However, Section 11 does not apply in the following cases: Stock Exchange, Association ‘Not for Profit-making’, Joint Hindu Family.

Effects of an Illegal Association

Following are the effects of an illegal association:

1. Every member is personally liable for all liabilities incurred in the business.
2. Members are punishable with fine which may extend up to Rs.10, 000.
3. Such an association cannot enter into any contract.
4. Such an association cannot sue any of its members or any outsider, not even if the association is subsequently registered as a company.
5. It cannot be sued by a member or an outsider for any debts due to it because it cannot contract any debt.
6. It cannot be wound up even under the provisions relating to winding up of un-registered companies.
7. While an unregistered firm can be dissolved, an illegal association cannot be dissolved because law does not recognize its very existence.
8. The illegality of an illegal association cannot be cured by subsequent reduction in the number of its members.
9. The profits made by an illegal association are, however, liable to assessment to income-tax.

Classification of Companies

Companies can be classified into three categories according to the mode of incorporation. If a company is incorporated by a charter granted by the monarch, it is called as **Chartered Company** and is regulated by that charter. For example, the East India Company came into being by the grant of a Royal Charter. Such types of companies do not exist in India. A company which is created by a Special Act of the Legislature is called a **Statutory Company** and is governed by the provisions of that Act. (E.g. The State Bank of India). A company brought into existence by registration of certain documents under the Companies Act, 1956 is called **Registered Company**. The liability of members of a registered company may be limited or unlimited (Section 12). It may be limited by shares, or by guarantee or by both (i.e., shares and guarantee).

A company limited by shares is a registered company having the liability of its member limited by its memorandum of association to the amount, if any, unpaid on the shares respectively held by them. A shareholder cannot be called upon to pay more than the amount remaining unpaid on his shares. His personal assets cannot be called upon for the payment of the liabilities of the company, if nothing remains to be paid on the shares purchased by him. Such a company is also known as a “**Share Company.**” **A company limited by guarantee** is one having the liability of its members limited by the memorandum to such amount as the members may respectively undertake by the memorandum to contribute to the assets of the company in the event of its being wound up. Such a company is also known as a “**Guarantee Company**”. A pure “guarantee company” does not have a share capital.

A Company Limited by Shares as well as by Guarantee: It is a hybrid form of company which combines elements of the guarantee and the share company. Such a company raises its initial capital from its shareholders.

Private and Public Companies: Either of the above kinds of companies (i.e., a limited liability company and an unlimited liability company) may be private or public (Sec. 12).

Private Company: A private company can be formed by merely two persons by subscribing their names to the Memorandum of Association. Such a company must have a minimum paid-up capital of Rs. 1 lakh and by its articles must:

- (i) Prohibit an invitation to the public to subscribe to its shares and debentures;
- (ii) Restrict the rights of its members to transfer shares; and
- (iii) Limit the number of its members to fifty, excluding its employee-members or past employee-members; provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purpose of this definition, be treated as a single member.
- (iv) Prohibits any invitation or acceptance of deposits from persons other than its member, directors or their relatives.

Public Company: [Section 3(1) (IV)] Companies (Amendment) Act, 2000 defines a public company to mean a company which –

- (i) Is not a private company.
- (ii) Has a minimum paid-up capital of five lakh rupees or such higher paid-up capital, as may be prescribed;
- (iii) Is a private company, which is a subsidiary of a company, which is not a private company? Minimum number of members required to form a public company is 7. However, there is no limit to the maximum number of members. (Sec. 12).

Private Company which is a subsidiary of public company: A private company which is a subsidiary of a public company will be treated as a public company from the date of commencement of the Companies (Amendment) Act, 2000.

Deemed Public Company: The Companies (Amendment) Act. 2000 has, by introducing sub-section (11) to Section 43A, made a private company will not automatically become a public company on account of shareholding or turnover.

Conversion of Private Company into a Public Company: Section 44 provides for conversion of a private company into a public company. The procedure is:

- (i) Special Resolution;
- (ii) Increase in Members/Directors;
- (iii) The Word “Private” is to be deleted before the word limited in the name;

- (iv) Within thirty days of the passing of the special resolution altering the articles, the company shall file with the Registrar (i) a printed or typewritten copy of the special resolution, and (ii) a prospectus or a statement in lieu of prospectus [Sec.44(a)]

Conversion of Public Company into a Private Company: A public company having a share capital, and membership within the limits imposed upon private companies by section 3(1) (iii), may become a private company by following the procedure as given below:

1. Pass special resolution for altering the articles so as to include there in the necessary restrictions, limitation and prohibitions and to delete any provision inconsistent with the restrictions.
2. The word Private should be added before Limited.
3. The approval of the Central Government to the alternation in the articles for converting a public company into a private company should be obtained.
4. Within one month of the date of the receipt of the order of approval, a printed copy of the altered articles must be filled with the Registrar.
5. Within thirty days of the passing of the special resolution, a printed or typewritten copy there of should be filed with the Registrar.

Holding and Subsidiary Companies: Where a company has control over another company, it is known as the Holding Company and the company over which control is exercised is called the Subsidiary Company. A Company is deemed to be under the control of another if:

1. That other controls the composition of its Board of Directors; or
2. The other company holds more than half in nominal value of its equity share capital
3. It is subsidiary of a third company which itself is a subsidiary of the controlling company. For example, where company 'B' is a subsidiary of company 'A' and company 'C' is a subsidiary of company 'B' then company 'C' shall be a subsidiary of company 'A'. If Company 'D' is a subsidiary of company 'C', then company 'D' shall also be a subsidiary of company 'B' and consequently also of company 'A'.

One Man Company: A member may hold virtually the entire share capital of a company. Such a company is known as a "one-man company". This can happen both in a private company and a public company. The other member/members of the company may be holding just one share each. Such other members may be just dummies for the purpose of fulfilling the requirements of law as regards minimum membership [**Salomon v. Salomon & Co. Ltd.**].

Non –Trading Company/Non – Profit Association: Such a company must have the objects of promoting of commerce, arts, science, religion, charity or any other useful object and must apply its profit, if any, or other income in promoting its object and must prohibit payment of any dividend to its members. As soon as it obtains a license and is

registered accordingly, it will have the same privileges and obligations that a limited company has under the Companies Act, 1956.

Govt. Companies: Section 617 defines a Government company as any company in which not less than fifty-one per cent of the paid-up share capital is held by the Central Government, or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments. A subsidiary of a Government company is also treated as a Government company.

Foreign Companies (591 to 602): A foreign company is a company which is incorporated in a country outside India under the law of that other country and has a place of business in India. There are of two types: (1) Companies incorporated outside India, establish a place of business in India after April 1, 1956; and (2) Companies incorporated outside India, which established a place of business in India before that date and continue to have an established place of business in India.

Investment Companies: An investment company is a company the principal business of which consists in acquiring, holding and dealing in shares and securities. It involves only the acquisition and holding of shares and securities and thereby earning income by way of interest, dividend, etc.

FERA Companies: The FERA companies are those companies which are incorporated in India in which the non-resident interest (viz., foreign equity share capital) was more than 40%. After the Amendment of FERA 1973 in the year 1993, the erstwhile FERA companies would not in future be subjected to obtain the prior approval of the RBI in respect of certain matters.

Finance Companies: A finance company means a non-banking company which is a financial institution within the meaning of clause (c) of sec.45 of the RBI Act, 1934.

Public Financial Institutions (Sec. 4-A): The following financial institutions shall be regarded, for the purposes of the Companies Act, as public financial institutions, namely:

1. The Industrial Credit and Investment Corporation of India Limited (ICICI)
2. The Industrial Finance Corporation of India (IFCI)
3. The Industrial Development Bank of India (IDBI)
4. The Life Insurance Corporation of India (LIC)
5. The Unit Trust of India (UTI)
6. The Infrastructure Development Finance Company Ltd.”

Sub-section (2) of Sec. 4-A empowers the Central Government to specify any other institution, as it may think fit, to be a public financial institution by issuing a notification in the Official Gazette.

Formation of a Company

We shall discuss the formation in three heads:

1. Promotion;
2. Registration;
3. Floatation

Promotion: Promotion is a term of wide import denoting the preliminary steps taken for the purpose of registration and floatation of the company.

Duties and Liabilities of Promoters

Duties: The promoters to make a full disclosure of all material facts relating to the formation of the company. He should not make any secret profit at the expense of the company he promotes, without the knowledge and consent of the company and if he does so, the company can compel him to account for it.

Liabilities: For Non-disclosure: In case a promoter fails to make full disclosure at the time the contract was made, the company may either:

1. Rescind the contract and recover the purchase price where he sold his own property to the company, or
2. Recover the profit made, even though rescission is not claimed or is impossible, or
3. Claim damages for breach of his fiduciary duty. The measure of damages will be the difference between the market value of the property and the contract price.

Registration (Sec 12, 33): Availability of Name: Section 20 states that a company cannot be registered by a name, which in the opinion of the Central Government is undesirable. Therefore, it is advisable that promoters find out the availability of the proposed name of the company from the Registrar of companies.

Procedure: The promoters will have to get together at least seven person in the case of public company, or two persons in the case of a private company to subscribe to the memorandum of association.

Documents to be Delivered: Section 33 states that the following three documents are required to be presented for the purpose of registration of a company:

1. The memorandum of the company;
2. The articles, if any;
3. The agreement, if any, which the company proposes to enter into with any individual for appointment as its managing or whole time director or manager.

Statutory Declaration of Compliance: Section 33 also requires a declaration to be filed with the Registrar of Companies along with the Memorandum and the Articles. This is known as “Statutory Declaration of Compliance.”

Consent of Directors: In case of a public company, if the first directors are appointed by the articles then the following must be complied with before the registration of articles with the Registrar of Companies:

1. Written consent of those directors to act, signed by themselves, or by an agent duly authorized in writing, and
2. An undertaking in writing signed by each such director to take from the company and pay for his qualification shares (if any). Other Documents are usually delivered along with the aforesaid documents:
 - a) The address of the registered office of the company (Sec. 146).
 - b) Particulars regarding directors, manager and secretary, if any (Sec 303).These two documents are required to be submitted within 30 days of registration of the company.

Certificate of Incorporation/Consequences of Incorporation: This certificate serves the same purpose in the case of a company which a birth certificate does in the case of a natural person.

Effect of Certificate of Incorporation: The certificate of incorporation is conclusive evidence that all the requirements of the Companies Act in respect of registration and of matters precedent and incidental thereto have been complied with.

Floatation/Capital Subscription: When a company has been registered and has received its certificate of incorporation, it is ready for “floatation”, i.e., it can go ahead with raising capital sufficient to commence business and to carry it on satisfactorily. Section 70 makes it obligatory for every public company to take either of the following two steps:

1. Issue a prospectus in case public is to be invited to subscribe to its capital; or
2. File a ‘statement in lieu of prospectuses with the Registrar, in case capital has been arranged privately. It must be done at least 3 days before allotment.

Certificate to Commence Business: Where the company has issued a prospectus – Section 149(1) it shall not commence business or exercise any borrowing powers unless:

1. Minimum subscription;
2. Every director of the company has paid to the company;
3. No money is, or may become, liable to be repaid to the applicants;
4. Filed with the Registrar a duly verified declaration by one of the directors or the secretary.

Where the company has not issued a prospectus Section 149(2) requires that it shall not commence business or exercise its borrowing powers unless:

1. It has filed with the Registrar a statement in lieu of prospectus;
2. Every director of the company has paid to the company on each of the shares taken or contracted to be taken by him.

3. Filed with the Registrar duly verified declaration by one of the directors or the secretary. Penalty: every person at fault is liable to a fine up to Rs.5, 000 for every day of default.

8.2 MEMORANDUM AND ARTICLES OF ASSOCIATION

The Memorandum of Association of a company is its charter which contains the fundamental conditions upon which alone the company can be incorporated. It tells us the objects of the company's formation and the utmost possible scope of its operations beyond which its actions cannot go. If anything is done beyond the powers that will be **ultra vires** (beyond powers of) of the company and so void. It enables shareholders, creditors and all those who deal with the company to know what its powers are and what is the range of its activities.

Form and Contents: Shall be in such one of the Forms in Tables B, C, D and E in Schedule I to the Companies Act, 1956 as may be applicable in the case of the company, or in Forms as near thereto as circumstances admit. Section 13 requires the memorandum of a limited company to contain: (i) the name of the company, with "limited" and "private limited" the name of the State, the objects of the company, the declaration that the liability of the members is limited; and the amount of the authorized share capital, divided into shares of fixed amounts.

The Name Clause (Sec. 13(1)(a)): The last word in the name of the company, if limited by shares or guarantee is 'limited' unless the company is registered under Sec.25 as an 'association not for profit' (Sec. 13(1)(a) and 25)].

The Registered Office Clause (Sec. 13(1) (b)): This clause states the name of the State in which the registered office of the company will be situated. Every company must have registered office which establishes its domicile, and it is also the address at which company's statutory books must normally be kept and to which notices, and all other communication can be sent.

The Objects Clause (Sec. 13(1) (d)): The objects clause defines the objects of the company and indicates the sphere of its activities. A company cannot do anything beyond or outside its objects and any act done beyond them will be ultra vires and void, and cannot be ratified even by the assent of the whole body of shareholders. Section 13, read along with Tables "B", 'C', 'D' and E', requires the company to divide its objects clause into two parts:

1. **Main objects** of the company to be pursued by the company on its incorporation and object incidental or ancillary to the attainment of the main objects; and
2. **Other objects** of the company not included in (a) above.

Liability Clause [Sec. 13(2)]: This clause states the nature of liability of the members. In case of a company with limited liability, it must state that liability of members is limited, whether it be by shares or by guarantee. In case of companies limited by guarantee, this

clause will state the amount which every member undertakes to contribute to the assets of the company in the event of its winding-up. In fact, the absence of this clause in the memorandum means that the liability of its members is unlimited.

The Capital Clause [Sec. 13(4) (c)]: This clause states the amount of share capital with which the company is registered and the mode of its division into shares of fixed value, i.e., the number of shares into which the capital is divided and the amount of each share.

The Association Clause [Sec. 13(4) (c)]: The names, addresses, descriptions, occupations of the subscribers, and the number of shares each subscriber has taken and his signature attested by a witness.

Doctrine of Ultra Vires (Beyond Powers)

The company's activities are confined strictly to the objects mentioned in its Memorandum, and if they go beyond these objects, then such acts will be ultra vires. The object of declaring such acts as ultra vires is to protect the interests of shareholders and all others who deal with the company.

1. Ultra vires the directors (Not Void)
2. Ultra vires the Articles of Association (Not Void)
3. Ultra vires the Memorandum of Association/Company (Void)

Effects of Ultra Vires

1. Injunction against the company;
2. Personal liability of directors to the company;
3. Personal liability of directors to third party;
4. Ultra vires contracts are void.

Exceptions to Doctrine of Ultra Vires

1. Acquires some property;
2. Property can be recovered, exists and is traceable
3. Ultra vires loan to pay its own debts – can recover the money from the company;
4. Any person borrows money from the company – the company has right to sue and recover the money from him;
5. The company may compel the director to refund the money;
6. The company is held liable for the ultra vires torts (civil wrongs) of its employees when it is proved.
 - (i) A company exists only for the objects which are expressly stated in its objects clause
 - (ii) Any act done outside the express or implied objects is ultra vires.
 - (iii) The ultra vires acts are null and void ab initio.

- (iv) The members of a company (even a single member) can get an order of injunction from the Court restraining the company from going ahead with the ultra vires act.
- (v) If the directors have exceeded their authority such matter can be ratified by the general body of the shareholders, provided the company has the capacity to do by its memorandum of association.
- (vi) Any property acquired by a company under an ultra vires transaction may be protected by the company against damage by third persons.
- (vii) Directors and other officers can be held liable to compensate the company for any loss occasioned to it by an ultra vires act.
- (viii) Directors and other officers shall be personally accountable to the third parties.
- (ix) Money or property gained through an ultra-vires transaction available in specie or capable of being identified shall be restituted (restored) to the other party.
- (x) In case, an ultra-vires loan, taken by a company is used for payment of its intra-vires debts, the lender of the ultra loan is substituted in place of the creditor who has been paid off and as such can recover the money.

Alteration of Memorandum

Section 16 provides that the company can not alter the conditions contained in memorandum except in the cases and in the mode and to the extent express provision has been made in the Act.

Change of Name: The name of a company may be changed at any time by passing a special resolution at a general meeting of the company and with the written approval of the Central Government.

Change of Registered Office:

(a) Change of registered office from one premises to another premises in the same city, town or village. A resolution passed by the Board of directors shall be sufficient.

(b) Change of registered office from one town or city or village to another town or city or village in the same State. The following procedures are to be followed;

- Special Resolution
- Confirmation of Regional Director
- Copy of Special Resolution and Confirmation by Regional Directors to be filed with RoC.
- Notice of new Location. Within 30 days the notice of the new location has to be given to the Registrar who shall record the same.

(c) Change of Registered Office from one State to another State. Can be done by a special resolution which is required to be confirmed by the Company Law Board (CLB).

Alteration of Objects Clause (Section 17): Empowers a company to change the place of its Registered Office from one State to another or to alter its objects by passing a special resolution, if alteration is sought on any of the following grounds:

1. To carry on its business more economically and more efficiently
2. To attain its main purpose by new or improved means
3. To enlarge or change the local area of its operation
4. To carry on some business which under existing circumstances may be conveniently or advantageously combined with the business of the company
5. To restrict or abandon any of the objects specified in the memorandum.
6. To sell or dispose of the whole or any part of the undertaking.
7. To amalgamate with any other company or body of persons.

Alteration of Liability Clause (Sec. 38): The liability of a member of a company cannot be increased unless the member agrees in writing. Increase in liability may be by way of subscribing for more shares than the number held by him at the date on which the alteration is made or in any other manner.

Alteration of Capital Clause (Section 94): It provides that, if the articles authorize, a company limited by share capital may, by an ordinary resolution passed in general meeting, alter the conditions of its memorandum in regard to capital so as

1. To increase its authorized share capital;
2. To consolidate and divide all or any of its share capital into shares of larger amount than its existing shares;
3. To convert all or any of its fully paid-up shares into stock, and reconvert the stock into fully paid-up shares of any denomination;
4. To sub-divide its shares, or any of them, into shares of smaller amount;
5. To cancel shares which have not been taken or agreed to be taken by any person?

Articles of Association

The articles of association of a company and its bye laws are regulations which govern the management of its internal affairs and the conduct of its business. They define the duties, rights, powers and authority of the shareholders and the directors in their respective capacities and of the company, and the mode and form in which the business of the company is to be carried out.

Registration of Articles: Section 26 states that a public company limited by shares may register articles of association signed by the subscribers to the memorandum. There are actually three possible alternatives in which such company may adopt articles:

1. It may adopt Table A in full or,
2. It may wholly exclude Table A and set out its own regulations in full, or
3. It may set out its own articles and adopt part of Table A.

No Article Company (Sec. 28): A company limited by shares may either frame its own set of articles or may adopt all or any of the regulations contained in Table 'A' [Section 28(1)]. But if it does not register any Articles, Table 'A' applies.

Subject matter of Articles/Contents

The articles of a company usually deal with the following matters:

1. The business of the company;
2. The amount of capital issued and the classes of shares the increase and reduction of share capital;
3. The rights of each class of shareholders and the procedure for variation of their rights;
4. The execution or adoption of a preliminary agreement, if any; the allotment of shares; calls and forfeiture of shares for non-payment of calls;
5. The allotment of shares; calls and forfeiture of shares for non-payment of calls;
6. Transfer and transmission of shares;
7. Company's lien on shares;
8. Exercise of borrowing powers including issue of debentures;
9. General meetings, notices, quorum, proxy, poll, voting resolution, minutes;
10. Number, appointment and powers of directors;
11. Dividends – interim and final – and general reserves;
12. Accounts and audit;
13. Keeping of books-both statutory and others.

Form and Signature of Articles [Sections 29 & 30]: The articles of association of any company not being a company limited by shares, shall be in one such form in Tables 'C', 'D', and 'E' in Schedule I as may be applicable. Section 30 requires that articles shall:

1. Be printed;
2. Be divided into paragraphs numbered consecutively;
3. Be signed by each subscriber of the memorandum of association.

Inspection and Copies of the Articles: A company shall, on being so required by a member, send to him within seven days of the requirement, on payment of one rupee, a copy of the articles.

Alteration of Articles

A company may, by special resolution alter or add to its articles. A printed or type written copy of every special resolution altering the articles must be filed with the Registrar within 30 days of the passing of the special resolution.

Effect of Memorandum and Articles/ Binding Force of Memorandum and Articles

Members bound to company:

Each member must observe the provisions of the articles and memorandum.

Company bound to members:

A company is bound to members by whatever is contained in its memorandum and articles of association.

Member bound to member:

The articles bind the member inter se, i.e., one to another so far as rights and duties arising from the articles are concerned.

Whether company or members bound to outsiders?

No, the memorandum or articles do not confer any contractual rights to outsiders against the company or its members, even though the name of the outsiders is mentioned in the articles.

Whether directors are bound by whatever is contained in the Articles?

Yes, the directors of the company derive their powers from the articles and are subjected to limitations, if any, placed on their powers by the articles.

Constructive Notice of Articles and Memorandum

The memorandum and articles when registered become public documents and then they can be inspected by anyone on payment of a nominal fee. Every person dealing with the company is presumed to have read these documents and understood them in their true perspective. This is known as 'Doctrine of Constructive Notice'.

Doctrine of Indoor Management

The doctrine of indoor management allows all those who deal with the company to assume that the provisions of the articles have been observed by the officers of the company. In other words, they are not bound to enquire into the regularity of internal proceedings. An outsider is not expected to see that the company carries out its internal regulations.

Exceptions: The doctrine of indoor management is subject to the following exceptions:

1. Knowledge of Irregularity.
2. No knowledge of Articles: The rule cannot be invoked in favour of a person who did not consult the memorandum and articles and, thus did not rely on them.
3. Void or Illegal Transaction. The rule does not apply to transactions which are void or illegal ab initio, e.g., forgery.
4. Negligence: If an officer of a company does something which would not ordinarily be within his powers, the person dealing with him must make proper enquiries and satisfy himself as to the officer's authority. If he fails to make inquiry he cannot rely on the rule.

5. Doctrine does not apply where question is in regard to very existence of agency.

Doctrine is not applicable where a precondition is to be fulfilled before company itself can exercise a particular power

8.3 PROSPECTUS

A prospectus means any document described or issued as prospectus and includes any notice, circular, advertisement or other document inviting deposits from the public or inviting offers from the public for the subscription or purchase of any shares in or debentures of a body corporate. Thus, a prospectus is not merely an advertisement; it may be a circular or even a notice. A document shall be called a prospectus if it satisfies two things:

1. It invites subscriptions to shares or debentures or invites deposits.
2. The aforesaid invitation is made to the public.

The Board attends to the following matters:

1. Appointment of various expert agencies such as bankers, auditors, secretary, etc.
2. Entering into underwriting contract, brokerage contracts.
3. Making arrangements for the listing of shares on stock exchanges.
4. Drafting a prospectus for the purpose of issue to the public.

Underwriting

Underwriting, in its simplest form, consists of an undertaking by some person or persons that if the public fails to take up the issue, he or they will do so. In return for this undertaking, the company agrees to pay the underwriter a commission on all shares or debentures, whether taken up by the public or by the underwriters.

Sub-Underwriting

The underwriters usually choose to spread their risk by using sub-underwriters who agree to take a certain number of shares for which they accept responsibility and for which they receive a commission out of the commission received by the underwriters. The difference between the commission paid by the company to the principal underwriters and the commission paid by them to the sub-underwriters is known as overriding commission.

Brokerage Contracts

There must be authority in the articles to pay brokerage, and the brokerage must be disclosed in the prospectus, or statement in lieu of prospectus, as the case may be, and it should pay a reasonable brokerage. (Sec. 76)

Listing of Shares on a Stock Exchange

The eligibility criteria for listing of securities of a company are:

- (i) Minimum issued equity capital of a company should be Rs. 5 crores [Rs.3 crores where trading is screen-based], and
- (ii) The minimum public offer of equity capital shall be not less than 25 per cent.

Time of Floatation: The Board of Directors will decide about the time of issue of prospectus. It is advisable to consider the condition of the capital market, the investors' mood, fiscal and monetary policies of the Government and the state of business conditions before issuing a prospectus.

Dating of Prospectus: Sec. 55 states that every prospectus must be dated and the date is deemed to be the date of publication of the prospectus. Section 56 of the Companies Act lays down that the matters and reports stated in Schedule II to the Companies Act must be included in a prospectus.

Abridged Form of Prospectus: In stead of appending full prospectus, now 'abridged prospectus' need only be appended to the application form. Form 2-A has been prescribed as a format of abridged prospectus.

When 'Abridged Prospectus' Not Necessary? In the following circumstances, an 'abridged prospectus' need not accompany the application forms:

- (i) A bonafide invitation to a person [Sec. 56(3)(a)]
- (ii) When shares or debentures are not offered to the public [Sec.56 (3) (b)].
- (iii) Where offer is made only to existing members/debenture holders of the company by way of rights, whether with or without the right of renunciation [Sec.56 (5) (a)].
- (iv) In the case of issue of shares or debentures which are in all respects similar to those previously issued and dealt in and quoted on a recognized stock exchange [Sec.56(5) (b)].

Registration of the Prospectus (Section 60): A copy of the prospectus duly signed by every director or proposed directors must be delivered to the Registrar before its publication.

Is the issue of prospectus compulsory?: when prospectus is not required to be issued?

The following are the circumstances:

- (i) A private company
- (ii) If the promoters or directors feel that they can mobilize resources through personal relationship and contacts.
- (iii) A memorandum containing the prescribed salient features of a prospectus.

- (iv) A bonafide invitation to a person to enter into an underwriting agreement Sec.56(3)
- (v) Application form is issued in relation to shares or debentures not offered to the public [Sec. 56(3)]
- (vi) Offered to existing holders of shares or debentures[Sec. 56(5)]
- (vii) The issue relates to shares or debentures previously issued [Sec. 56(5)]
- (viii) Where invitation is made in the form of an advertisement, ordinarily called as “prospectus announcement’ [Sec. 66].

Shelf Prospectus and Information Memorandum [Section 60A and 60 b]: The Companies (Amendment) Act, 2000 has introduced two new sections, viz., Sections 60A and 60B relating to ‘Shelf Prospectus’ and ‘Information Memorandum’ respectively. ‘Shelf prospectus’ means a prospectus issued by any financial institution or bank for one or more issues of the securities or class of securities specified in that prospectus.

Information Memorandum (Section 60B): ‘Information memorandum’ means a process undertaken prior to the filing of a prospectus by which a demand for the securities proposed to be issued by a company is elicited, and the price and the terms of issue for such securities is assessed, by means of a notice, circular, advertisement or document [Section 2(19B)].

8.4 STATEMENT IN LIEU OF PROSPECTUS (SECTION 70)

If a public company makes a private arrangement for raising its capital then it must file a statement in lieu of prospectus with the Registrar at least three days before any allotment of shares or debentures can be made. If allotment of shares or debentures is made without filing the Statement in lieu of prospectus, the allottee may avoid it within two months after the statutory meeting, or where no such meeting is to be held, within two months of the allotment. Contravention also renders the company and every director liable to a fine up to Rs. 10, 000.

Liability for Untrue Statements in the Prospectus (Sections 62-63)

The prospective shareholders are entitled to all true disclosures in the prospectus. The persons issuing the prospectus are bound to state everything accurately and not to omit material facts.

What is an untrue statement? According to Section 65(1) if the statement is misleading in the form and context in which it is included; and where the omission from a prospectus of any matter is calculated to mislead, to be a prospectus in which an untrue statement is included.

Civil Liability (Section 62): The following persons shall be liable to pay compensation to every subscriber for loss or damage:

1. Director of the company at the time of the issue of the prospectus;
2. Person who has authorized himself to be named and is named in the prospectus as a director,
3. Every promoter of the company; and
4. Who has authorized the issue of the prospectus?

Remedies against the Company: Any person who takes shares from the company may

1. Rescind the contract to take the shares
2. Claim damages. He must, however, take action to rescind the contract:
 - a) Within a reasonable time,
 - b) Before proceedings to wind up the company have commenced, and
 - c) Before he does anything, which is inconsistent with the right to repudiate, e.g., to accept dividends.

Remedies against Directors or Promoters: A shareholder who had been induced to take shares may claim:

1. Damages for fraudulent misrepresentation;
2. Compensation under Section 62;
3. Damages for noncompliance with the requirements of Section 56 regarding contents of the prospectus.

Damages for Fraudulent Misrepresentation: An allottee of shares may bring an action for deceit, i.e., fraudulent misrepresentation.

Compensation for untrue Statement [Sec. 62]: File a suit for compensation under Section 62. A claim can be made, whether the statements are fraudulent or innocent.

Remedies against Experts: The allottee of the shares is entitled to claim from the expert: (i) damages, (ii) compensation under Section 62.

Liability under Section 56: An omission from a prospectus of a matter required to be stated under Section 56 (i.e., as per Sch.II) may give rise to an action for damages at the instance of a subscriber for shares, who has suffered loss.

Criminal Liability for Misstatement in Prospectus (Section 63): Every person authorizing its issue is punishable:

- (i) With imprisonment for a term up to two years,
- (ii) With fine up to Rs. 50,000, or
- (iii) With both imprisonment and fine.

Liability under Section 68: Every person authorizing its issue shall be punishable with imprisonment for a term which may extend to 5 years or with fine which may extend to Rs. 1, 00,000 or with both.

Golden Rule for framing of Prospectus: The ‘Golden Rule’ for framing of a prospectus was laid down by Justice Kindersley in *New Brunswick & Canada Rly. & Land Co. V. Muggeridge* (1860). Briefly, the rule is:

“Those who issue a prospectus hold out to the public great advantages which will accrue to the persons who will take shares in the proposed undertaking”.

Thus, the persons issuing the prospectus must not include in the prospectus all the relevant particulars specified in Parts I & II of Schedule II of the Act, which are required to be stated compulsorily but should also voluntarily disclose any other information within their knowledge which might in any way affect the decision of the prospective investor to invest in the company.

8.5 SHARE & SHARE CAPITAL

Meaning of a Share: Section 2(46) defines a share “as a share in the share capital of a company and includes stock except where a distinction between stock and share is expressed or implied. A share signifies the following:

1. The interest of a shareholder in the company; the right to receive dividend, attend meetings, vote at the meeting and share in the surplus assets of the company, if any, in the event of the company, being wound up;
2. The liability of the shareholder in the company to pay calls on shares until fully paid up;
3. The right of the shareholder to transfer the shares subject to the articles of association.
4. Binding covenants on the part of the company as well as the shareholder, as given in the Articles of the company.

Thus, a share of a company in the hands of a shareholder signifies a bundle of rights and obligations. A share is not a negotiable instrument.

Share Vs. Share Certificate: Sec. 82 of the Companies Act. 1956, describes a share as a moveable property transferable in the manner provided by the articles of the company and Sec. 84, on the other hand, describes a ‘share certificate’ to mean a certificate, under the common seal of the company, specifying any shares held by any member.

Share vs. Stock

Share:

The share capital of a company is divided into a number of indivisible units of specified amount. Each of such unit is called a ‘share’.

Stock:

The term 'stock' may be defined as the aggregate of fully paid-up shares of a member merged into one fund of equal value. It is a set of shares put together in a bundle. The 'stock' is expressed in terms of money and not as so many shares. Stock can be divided into fractions of any amount and such fractions may be transferred like shares.

Distinction: Following are the main points of difference:

	Share		Stock
1.	A share has a nominal value.	1.	A stock has no nominal value.
2.	A share has a distinctive number which distinguishes it from other shares.	2.	A stock bears no such number.
3.	Share can be issued originally to the public	3.	A company cannot make an original issue of stock. Stock can be issued by existing company by converting its fully paid-up shares.
4.	A share may either be fully paid-up or partly paid-up.	4.	A stock can never be partly paid-up, it is always fully paid-up.
5.	A share cannot be transferred in fractions. It is transferred as a whole.	5.	A stock may be transferred in any fractions.
6.	All the shares are of equal denomination.	6.	Stock may be of different denominations.

Classes of Shares: The most common classes of shares are:

1. Preference;
2. Equity or Ordinary; and
3. Deferred or Founders.

A public company and a private company which is a subsidiary of public company may not issue shares other than equity, preference and cumulative convertible preference shares (CCPS).

Preference Share: A preference share is one which carries the following two rights over holders of equity shares:

1. A preferential right in respect of dividends at a fixed amount or at a fixed rate;
2. A preferential right in regard to repayment of capital on winding up.

The preference or priority of the preference shareholders is in relation to the rights of equity shareholders [Section 85].

Participating and Non-participating: If a preference share carries either one or both of the following rights then it is known as participating share:

1. To participate further in the profits either along with or after payment of a certain rate of dividend on equity shares,
2. To participate in the surplus assets at the time of winding up [Section 85].

Thus, if a preference share does not carry either of these rights, then it will be known as non-participating share. If a preference share carries the right for payment of arrears in dividend from future profits, then such a share is known as cumulative preference share. If a preference share does not carry the right to dividend in arrears, then such a preference share is known as non-cumulative or simple. The preference shares are always presumed to be cumulative unless expressly described as non-cumulative.

Redeemable and Irredeemable: Redeemable preference shares are those shares which are to be redeemed by the company either at a fixed date, or after a certain period of time or at the option of the company as per Section 80.

Conditions: Shares issued earlier cannot be converted into redeemable preference shares:

There must be authority in the articles. The shares can be redeemed only when they are fully paid up; it will only be redeemed:

1. Out of profits of the company which would otherwise be available for dividend, or
2. Out of the proceeds of a new issue of shares.

If there is a premium payable on redemption, it must have been provided out of profits or out of the securities premium account before the shares are redeemed. Where the shares are redeemed out of profits, a sum equal to the nominal amount of the shares redeemed is to be transferred out of profits to the “Capital Redemption Reserve Account.”

Voting rights of preference shareholders: The preference shareholders will vote only on matters directly relating to preference shares. (i) any resolution for winding up of the company, (ii) any resolution for the reduction or repayment of share capital, (iii) any resolution at any meeting, if dividend on cumulative preference shares remains unpaid for at least two years

Equity Share: ‘Equity share’ means a share which is not preference share [Section 85]. The rate of dividend is not fixed. The Board of Directors recommends the rate of dividend which is then declared by the members at the Annual General Meeting. New issues of share capital of a company limited by shares shall be of two kinds only, namely:- (a) equity share capital: (i) with voting rights; or (ii) With differential rights as to dividend, voting or otherwise in accordance with such rules and subject to such conditions as may be prescribed; (b) Preference share capital. Prior to the Amendment to the companies Act in 2000, public companies were not allowed to issue equity shares with differential rights. Thus, companies are now allowed to issue non-voting equity

shares. The holders of equity shares carrying voting rights shall have voting rights in proportion to the paid-up equity capital of the company [Section 87(1)].

Cumulative Convertible Preference Shares (CCPs): Such shares are issued as preference shares but are convertible into equity shares within a period of 3 years to 5 years, as may be decided by the company.

Deferred or Founders' Shares: A pure private company can issue shares of a type other than those discussed above [Section 90]. Thus, it may issue what are known as deferred shares. As deferred shares are normally held by promoters and directors of the company, they are usually called founders' shares. They are usually of a smaller denomination, say one rupee each.

Issue of Shares at Par, at Premium, and at Discount

A company may issue shares at par, or at a premium, or at a discount.

Issue at Par: Shares are deemed to have been issued at par when subscribers are required to pay only the amount equivalent to the nominal or face value of the shares issued.

Par Value of Shares: 'Par value' is the notional face value of the shares which a company issues to its investors.

Issue at a Premium: If the buyer is required to pay more than the face value of the share, then the share is said to be issued or sold at a premium. The premium cannot be treated as profit and, therefore, cannot be distributed as dividend. The amount of premium received in cash and the equivalent of it received in kind must be kept in a separate bank account known as the 'Securities Premium Account'. As per SEBI guidelines, 2000 every company entitled to make a public issue can offer its shares at par or premium.

Issue at a Discount

If the buyer of shares is required to pay less than the face value of the share, then the share is said to be issued or sold at a discount. Certain conditions subject to which shares can be issued at a discount are authorized by a resolution:

1. The issue must be of a class of shares already issued
2. The maximum rate of discount must not exceed 10 per cent
3. Not less than one year has, at the date of issue, elapsed since the date on which the company was entitled to commence business.
4. Issued within two months of the sanction by the Company Law Board.
5. Every prospectus must mention particulars of the discount allowed on the issue of shares.

Issue of Sweat Equity Shares [Sec. 79A]: ‘Sweat-equity shares’ means equity shares issued by the company to employees or directors at a discount or for consideration other than cash. ‘Sweat equity shares’ may be issued for providing know-how or making available intellectual property rights (say, patents) or value additions, by whatever name called.

Conditions:

1. Must be of a class of shares already issued.
2. Authorized by a special resolution
3. The resolution specifies the number of shares, current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued.
4. Not less than one year has, at the date of the issue, elapsed since the date on which the company was entitled to commence business;
5. Are issued in accordance with the regulations made by the Securities and Exchange Board of India.

Bonus Shares: A company may, if the articles so provide, capitalize profits by issuing fully paid-up shares to the members thereby transferring the sums capitalized from the profit and loss account or Reserve Account to the Share Capital [Section 205(3)]. Such shares are known as bonus shares and are issued to the existing members of the company free of charge. The issue of bonus shares is regulated not only by the Companies Act, 1956 but also by the guidelines issued by SEBI in this regard.

Right Shares: The existing members of the company have a right to be offered shares, when the company wants to increase its subscribed capital. Such shares are known as “right shares” but they are not issued free of charge.

Share Capital

Meaning of share capital: It means the capital of a company, or the figure in terms of so many rupees divided into shares of a fixed amount, or the money raised by the issue of shares by a company.

Nominal, Authorized or Registered capital: This is the sum stated in the memorandum as the share capital of a company with which it is proposed to be registered. This is the maximum amount of capital which it is authorized to raise by issuing shares, and upon which it pays stamp duty.

Issued capital: It is the part of the authorized capital which the company has issued for subscription. The amount of issued capital is either equal to or less than the authorized capital.

Subscribed capital: It is that portion of the issued capital which has been subscribed for by the purchasers of the company’s shares. The amount of subscribed capital is either equal to or less than the issued capital.

Called-up capital: The company may not call up full amount of the face value of the shares. Thus the called-up capital represents the total amount called-up on the shares

subscribed. The total amount of called-up capital can be either equal to or less than the subscribed capital.

Uncalled capital: represents the total amount not called up on shares subscribed, and the shareholders continue to be liable to pay the amounts as and when called. The company may reserve all or part of the uncalled capital, which can then be called in the event of the company being wound up. It is known as **Reserve Capital** or Reserve Liability [Section 99].

Paid-up capital: Paid –up capital is the amount of money paid-up on the shares subscribed.

Alteration of share capital: Section 94 provides that, if the articles authorize, a company limited by share capital may, by an ordinary resolution passed in general meeting, alter the conditions of its memorandum in regard to capital to:

1. **Increase of authorized share capital:** A company limited by shares if the articles authorize, can increase its authorized share capital by passing an ordinary resolution.
2. **Consolidate and sub-divide shares:** Consolidation is the process of combining shares of smaller denomination, Sub-division of shares is just the opposite of consolidation.
3. **Convert shares into stock and vice versa:** Stock cannot be issued in the first instance. It is necessary to first issue shares and have them fully paid-up and then convert them into stock. Also stock can be reconverted into fully paid-up shares by passing a resolution in general meeting.
4. **Diminish share capital:** Section 94 provides that a company may cancel shares and diminish the amount of the share capital by the amount of the shares so cancelled. This constitutes diminution of capital and should be distinguished from reduction of capital.
5. **Reduce capital:** (i) by reducing or extinguishing the liability of members for uncalled capital. (ii) By paying off returning capital which is in excess of the wants of the company, (iii) Pay off paid-up capital on the understanding that it may be called up again. (iv) A Combination of the preceding methods. (v) Write off or cancel capital which has been lost or is not represented by available assets.

Reduction of share capital without the sanction of the court: There are some cases in which there is reduction of share capital and no confirmation by the court is necessary.

These are:

1. Forfeiture of shares
2. Surrender of shares
3. Diminution of capital
4. Redemption of redeemable preference shares.
5. Purchase of shares of a member by the company under section 402.
6. Purchase of its own shares as per section 77A

Raising of Capital/ Issue of Shares

Issue of shares may be made in 3 ways:

1. By private placement of shares;
2. By allotting entire shares to an issue-house, which in turn, offers the shares for sale to the public; and
3. By inviting the public to subscribe for shares in the company through a prospectus.

Private Placement of Shares: Shares are issued privately to a small number of persons known to the promoters or related to them by family connections.

By an Offer for sale: The Issue-house publishes a document called an offer for sale, with an application form attached, offering to the public shares or debentures for sale at a price higher than what is paid by it or at par. This document is deemed to be a prospectus [Section 64(1)].

By inviting public through prospectus: The company invites offers from members of the public to subscribe for the shares or debentures through prospectus.

Issue of shares to existing shareholders: The capital is also raised by issue of rights shares' to the existing shareholders (Sec.81). In the case, the shares are allotted to the existing equity shareholders in proportion to their original shareholding.

Public Issue of Shares

Public issue of shares means the selling or marketing of shares for subscription by the public by issue of prospectus.

Allotment of Shares: It means and implies a division of the share capital into defined shares of a particular value or of different classes and assignment of such shares to different persons.

Share Certificate (Section 113): The share certificate states the name, address, occupation of the holder together with the number of shares and their distinctive number and amount paid-up. It must bear the common seal of the company, must be stamped and bear the signature of one or more directors.

Share Warrants (Section 114): A share warrant is a negotiable instrument. It entitles the bearer to the shares specified in it and he can transfer the ownership of shares by merely delivering the share warrant to the transferee.

Membership: Membership can be in the following ways:

1. The subscribers of the Memorandum
2. Every other person who agrees in writing to become a member
3. Every person holding equity share capital of a company

Member and Shareholder: In the case of an unlimited company or a company limited by guarantee, a member may not be a shareholder.

Modes of Acquiring Membership: By subscribing to the memorandum of association.

1. By agreement and registration.
2. By agreeing to purchase qualification shares.

Calls on Shares: The company may ask for some payment at the time of application for shares (but money not less than 5 per cent of the nominal value) and another sum at allotment. The balance may be payable as and when called for.

Forfeiture of Shares: Forfeiture of shares means taking them away from the member. This is absolutely a serious step for not only does it deprive the shareholder of his property but also, unless the shares are re-issued, it involves a reduction of capital.

COMPANY LAW PART - II

9.1 Debentures

9.2 Company Management and Remuneration

9.3 Meeting and Resolutions

9.4 Account and Audit, Prevention of Oppression, and Mismanagement

9.5 Winding Up

9.6 Review Questions

9. 1: DEBENTURES

According to Sec. 2(12), 'debenture' includes debenture stock, bonds and any other securities of a company, whether constituting a charge on the assets of the company or not.

Characteristic features of a debenture: (1) Debentures is issued by a company and is usually in the form of a certificate which is an acknowledgement of indebtedness. (2) It is issued under the company's seal. (3) It is one of a series issued to a number of lenders. (4) It usually specifies a particular period or date as the date of repayment. (5) It generally creates a charge on the undertaking of the company or some parts of its property. (6) A debenture holder does not have any right to vote in the company meetings.

Classes of Debentures

Debentures may be classified according to the following characteristics, viz.

1. Negotiability,
2. Security,
3. Permanence,
4. Convertibility, and
5. Priority.

1. Classification according to negotiability:

- (1) Bearer debentures.
- (2) Registered debentures.

2. Classification according to security:

- (1) Secured debentures.

(2) Unsecured or naked debentures.

3. Classification according to permanence:

(1) Redeemable debentures.

(2) Irredeemable or perpetual debentures.

4. Classification according to convertibility:

(1) Convertible debentures.

(2) Non-convertible debentures.

5. Classification according to priority:

(1) First debentures.

(2) Second debentures.

Debentures with voting rights not to be issued (Sec. 117): A company cannot issue any debentures carrying voting rights

Issue of debentures at a discount: Debentures can be issued at a discount, unless the Articles provide otherwise.

Debentures and debenture stock: The difference between debentures and debenture stock is the same as the difference between shares and stock.

Debenture trust deed: [New Sec. 117-A as inserted by the Companies (Amendment) Act, 2000]. A trust deed for securing any issue of debentures shall be in specified form and shall be executed within the prescribed period.

Appointment of debenture trustees and duties of debenture trustees [Sec. 117-B]: A person shall not be appointed as a debenture trustee, if he –

(a) Beneficially holds shares in the company;

(b) Is beneficially entitled to moneys which are to be paid by the company to the debenture trustee;

(c) Has entered into any guarantee in respect of principal debts secured by the debentures or interest thereon.

Liability of company to create security and debenture redemption reserve [New Sec. 117-C as inserted by the Companies (Amendment) Act, 2000]: Creation of debenture redemption reserve: Where company issues debentures **after** the commencement of this Act, it shall create a debenture redemption reserve for the redemption of such debentures, to which adequate amounts shall be credited, from out of its profits every year until such debentures are redeemed.

Liability of trustees for debenture-holders (Sec.119): A trustee is liable for any breach of trust where he fails to show the degree of care and diligence required of him as trustee,

having regard to the provisions of the trust deed conferring on him any powers, authorities or discretions.

Remedies of Debenture Holders

1. He may sue for his principal and interest.
2. He may, petition under Sec. 439 for the winding up of the company by the Court. But in addition he has also the following courses open to him:
 - Debenture-holders' action.
 - Appointment of receiver.
 - Foreclosure.
 - Sale.
 - Proof for the balance

Creation of Charges: A company like any other person can, when it borrows money, give its-creditors security. Often it mortgages or charges its property to its debenture-holders.

Fixed and Floating Charges

Fixed charge: A fixed or specific charge is one which is created on some specific and definite assets of the company, e.g., a charge on land and building.

Floating charge: A floating charge is an equitable charge which is created on some class of property which is constantly changing, e.g., a charge on stock-in-trade, trade debtors, etc.

New financial instruments: Issuer of capital shall make instruments such as Deep Discount Bonds, Debentures wit Warrants, Secured Premium Notes etc., so that an investor can make reasonable determination of the risks, returns, safety and liquidity of the instruments.

9.2 COMPANY MANAGEMENT & REMUNERATION

Directors

A company in the eyes of the law is an artificial person. The persons who are in charge of the management of the affairs of a company are termed as directors. They are collectively known as Board of directors or the Board.

Only individuals can be directors (Sec. 253): No body corporate, association or firm can be appointed as director of a company.

Number of directors: Minimum number (Sec.252): Every public company (other than a deemed public company) shall have at least 3 directors and every other company (e.g., a private company, a deemed public company) at least 2 directors.

Appointment of Directors

1. First Directors (Sec. 254 and Clause 64 of Table A)

- a) The Articles of a company usually name the first directors by their respective names or prescribe the method of appointing them.
- b) If the first directors are not named in the Articles, the number of directors and the name of the directors shall be determined in writing by the subscribers of the Memorandum or a majority of them (Clause 64 of Table A).
- c) If the first directors are not appointed in the above manner, the subscribers of the Memorandum who are individuals become directors of the company.

2. Appointment of directors by the company (Sec. 255 to 257, 263 and 264)

Directors must be appointed by shareholders in general meeting. At least 2/3rds of the total number of directors shall be liable to retire by rotation. Such directors are called rotation directors. Appointment of a new director (Sec. 257): (1) Fourteen days' notice and deposit of Rs.500. (2) Consent in writing to act as director (Sec. 264). (3) Separate ordinary resolution for each appointment (Sec. 263). Retirement of directors where annual general meeting is not held: A director who is to retire by rotation at the annual general meeting shall not continue in office after the last day on which the annual general meeting in each year should have been held.

3. Appointment of director by directors (Sec. 260, 262 and 313)

The directors of a company may appoint directors:

- a) As additional directors (Sec. 260).
- b) In a casual vacancy (Sec. 262).
- c) As alternate director (Sec.313).

4. Appointment of directors by third parties: The number of directors so appointed shall not exceed 1/3rd of the total number of directors, and they are not liable to retire by rotation.

5. Appointment by proportional representation (Sec. 265): The system of proportional representation ensures representation of the minority shareholders on the Board of directors.

6. Appointment of directors by the Central Government (Sec. 408): Any director appointed by the Central Government shall not be required to hold any qualification shares.

Directors as agents: A company, as an artificial person, acts through directors who are elected representatives of the shareholders.

Directors as employees: Although the directors of a company are its agents, they are not employees or servants of the company for being entitled to privileges and benefits which are granted under the Companies Act to the employees.

Directors as officers: For certain matters under the Companies Act, the directors are treated as officers of the company [sec.2 (30)].

Directors as trustees: Directors are treated as:

1. Trustees of the Company's money and property; and
2. Trustees of the powers entrusted to them.

Qualifications of Directors

1. A director must be an individual,
2. A director must be competent to contract, and
3. A director must hold a share qualification, if so required by the Articles.

Disqualification of Directors (Sec. 274)

The following persons are disqualified for appointment as directors of a company:

1. A person of unsound mind.
2. An un-discharged insolvent.
3. A person who has applied to be adjudicated as an insolvent and his application is pending.
4. A person who has been convicted by a Court of any offence involving moral turpitude and a period of 5 years has not elapsed from the date of expiry of the sentence.
5. A person whose calls in respect of shares of the company held for more than 6 months have been in arrear.
6. A person who is disqualified for appointment as director by an order of the Court under Sec. 203.
7. A person, who is already a director of a public company which
 - has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after the first day of April, 1999; or
 - has failed to repay its deposit or interest thereon on due or redeem its debentures on due date or pay dividend and such failure continues for one year or more.

Vacation of Office, Removal and Resignation of Directors

Vacation of office by directors (Sec. 283):

1. Statutory Vacation.
2. Additional grounds in case of private companies.
3. Acceptance of officer of profit.

Removal of directors

Directors may be removed by:

1. The shareholders,
2. The Central Government
3. The Company Law Board.

(1) Removal by Share holders: In certain circumstances, the shareholders may remove the directors.

(2) Removal by Central Government: (Sec. 388-B to 388-E): The Central Government may, in certain circumstances, remove managerial personnel from office on the recommendation of the Company Law Board.

(3) Removal by Company Law Board (Sec. 402): Where, on an application to the Company Law Board for prevention of oppression (under Sec. 397) or mismanagement (under Sec. 398).

Resignation of directors: There is no provision in the Companies Act, 1956 relating to the resignation of office of a director.

Managerial Remuneration

Managerial personnel: The expression 'managerial personnel' refers to the following:

1. Managing director.
2. Whole-time/ part-time directors, or
3. Manager.

Overall maximum managerial remuneration (Sec. 198): Remuneration not to exceed 11 per cent: The total managerial remuneration of the directors and the manager in respect of any financial year shall not exceed 11 per cent of the net profit of the company for that financial year computed in the manner laid down in Sec. 349 and 350.

Meetings of Directors (Sec. 285 to 288)

1. Number of meetings – once in every 3 months (Sec. 285).
2. Notice of meetings (Sec. 286): Every officer of the company whose duty is to give notice and who fails to do so shall be punishable with fine which may extend to Rs.1,000.

3. Quorum for meetings (Sec.287): The quorum shall be 1/3rd of its strength or 2 directors, whichever is higher.

Powers of Directors

General Powers of the Board (Sec. 291): The Board of directors of company is entitled to exercise all such powers and to do all such acts and things as the company is authorized to exercise and do.

Powers to be Exercised at Board meetings (Sec. 292) .The following powers, on behalf of the company are to be exercised:

1. To make calls on shareholders in respect of money unpaid on their shares;
2. The Power to authorize the buy-back of shares;
3. Issue debentures;
4. To borrow moneys otherwise than on debentures;
5. To invest the funds of the company; and
6. To make loans.

Other powers: These powers are:

1. To fill vacancies in the Board (Sec. 262);
2. To sanction or give consent for certain contracts in which particular directors, their relatives and firms are interested (Sec. 297);
3. To receive notice of disclosure of directors' interest in any contract or arrangement with the company (Sec. 299);
4. To receive notice of disclosure of shareholdings of directors (Sec. 308);
5. To appoint as managing director or manager a person who is already managing director or manager of another company (Sec. 316 and 386) ;
6. To make investments in companies in the same group (Sec. 372).

Exceptions:

1. Directors acting mala fide.
2. Directors themselves wrong-doers.
3. Incompetency of Board.
4. Deadlock in management.
5. Residuary powers. i.e., powers not expressly conferred on the directors or shareholders, in a general meeting.

Powers to be exercised with the approval of company in general meeting (Sec. 293):

- (a) To sell, lease or otherwise dispose of.
- (b) To remit or give time for repayment of any debt.
- (c) To invest (excluding trust securities) the amount of compensation received.

- (d) To borrow moneys where the moneys to be borrowed (together with the moneys already borrowed by the company) are more than the paid-up capital.
- (e) To contribute to charitable and other funds not directly relating to the business.

Audit Committee [Sec. 292-A as introduced by the Companies (Amendment) Act, 2000]: The Audit Committee shall act in accordance with terms of reference to be specified in writing by the Board.

Duties of Directors

1. Fiduciary duties and 2. Duties of Care, Skill and Diligence.

1. Fiduciary Duties: As fiduciaries, the directors must

- (a) Exercise their powers honestly and bona fide for the benefit of the company as a whole; and
- (b) Not place them in a position in which there is a conflict between their duties to the company and their personal interests.

2. Duties of Care, Skill and Diligence: Directors should carry out their duties with reasonable care and exercise such degree of skill and diligence as is reasonably expected of persons of their knowledge and status.

Other duties of directors: The other duties of a director are –

- 1. To attend Board meetings,
- 2. Not to delegate his functions except to the extent authorized by the Act or the constitution of the company, and
- 3. To disclose his interest.

LIABILITIES OF DIRECTORS

1. Liability to third parties:

- 1. Material misrepresentations.
- 2. Independently of the Act: Directors, as agents of a company, are not personally liable on contracts entered into a agents on behalf of the company.
- 3. Liability for acts ultra vires the company: Where a director enters into a contract, which is ultra vires the company, the director is personally liable for breach of implied warranty of authority.
- 4. Liability for frauds and torts.

2. Liability to the company

The liability of directors towards the company may arise from-

- 1. Ultra vires acts,
- 2. Negligence,

3. Breach of trust, and
4. Misfeasance.

Other Managerial Personnel Managing Director

The term ‘managing director’ includes a director occupying the position of a managing director, by whatever name called.

Manager: ‘Manager’, according to Sec. 2 (24), means an individual who has the management of the whole or substantially the whole of the affairs of a company.

Managing Director and Manager compared

Managing director	Manager
1. A managing director is entrusted with the substantial powers of the management.	1. A manager has the management of the whole, or substantially the whole of the affairs of a company.
2. A company may have two managing directors.	2. A company can have only one manager as he is vested with the management of the whole or substantially of the whole or substantially the whole of the affairs of the company.
3. A managing director must be a director.	3. A manager may or may not be a director.
4. A managing director is appointed by the directors from among themselves and appointed either resolution of the Board or general meeting.	4. A manager is usually appointed by the Board of directors.

Sole Selling Agents: The term ‘sole selling agent’ is not defined in the Act, it means an individual, firm or company who or which is given exclusive rights to sell in a particular area the goods of the company concerned.

Secretary: A company secretary means “a person who is a member of the Institute of Company Secretaries of India”. According to Sec. 2 (45) of the Companies Act as amended in 1988 ‘secretary’ means a company secretary within the meaning of Sec. 2 (1) (c) of the Company secretaries Act, 1980, and includes any individual possessing the prescribed qualifications appointed to perform the duties which may be performed by a secretary under this Act and any other ministerial or administrative duties.

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9.3 MEETINGS AND RESOLUTIONS GENERAL MEETINGS OF SHAREHOLDERS

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I. Statutory Meeting (Sec. 165)

Every company limited by shares and every company limited by guarantee and having a share capital shall, within a period of not less than one month and not more than six months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company. This meeting is called the ‘statutory meeting’. This is the first meeting of the shareholders of a public company and is held only once in the lifetime of a company.

Statutory report: The Board of directors shall, at least 21 days before the day on which the meeting is to be held, forward a report, called the ‘statutory report’, to every member of the company.

Procedure at the meeting: (a) List of members. (b) Discussion of matters relating to formational aspect. (c) Adjournment.

Objects of the meeting and report

1. To put the members of the company in possession of all the important facts relating to the company.
2. To provide the members an opportunity of meeting and discussing the management, methods and prospects of the company.
3. To approve the modification of the terms of any contract named in the prospectus.

2. Annual General Meeting (Sec. 166 and 167):

Company to hold annual general meeting every year (Sec. 166) Every company shall in each year hold, in addition to any other meetings, a general meeting as its annual general meeting and shall specify the meeting as such in the notice calling it. There shall not be an interval of more than 15 months between one annual general meeting and another. But the first annual general meeting should be held within a period of 18 months from the date of its incorporation.

The Registrar may, for any special reason, extend the time for holding any annual general meeting by a period not exceeding 3 months. But no extension of time is granted for holding the first annual general meeting. Every annual general meeting shall be called during business hours on a day that is not a public holiday. It shall be held either at the registered office of the company or at some other place within the city, town or village in which the registered office of the company is situated. As regards holding of the annual

general meeting, no distinction is made between a public company and a private company. 21 days' notice (Sec.171): A general meeting of a company may be called by giving not less than 21 days' notice in writing.

Annual general meeting a statutory requirement: The annual general meeting of a company is a statutory requirement. It has to be called even where the company did not function during the year. Canceling or postponing of convened meeting: Where an annual general meeting is convened for a particular date and notice is issued to the members, the Board of directors can cancel or postpone the holding of the meeting on that date provided power is exercised for bona fide and proper reasons.

Canceling of failure to hold annual general meeting: If a company fails to hold an annual general meeting:

1. Any member can apply, under Sec. 167, to the Company Law Board for calling the meeting.
2. The company and every officer who is in default shall be punishable with fine.

Powers of Company Law Board to call annual general meeting (Sec. 167): If default is made by a company in holding an annual general meeting in accordance with Sec. 166, any member of the company may apply to the Company Law Board for calling such a meeting.

Penalty for default (Sec. 168): If default is made by a company in holding a meeting in accordance with Sec. 166 or in complying with any direction of the Company Law Board in calling a meeting under Sec. 167, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 2,500 for every day after the first during which such default continues.

3. Extraordinary General Meeting (sec. 169): A statutory meeting and an annual general meeting of a company are called ordinary meetings. Any meeting other than these meetings is called an extraordinary general meeting. It is called for transacting some urgent or special business which cannot be postponed till the next annual general meeting. It may be convened.

- (1) By the Board of directors on its own or on the requisition of the members; or
- (2) By the requisitionists themselves on the failure of the Board of directors to call the meeting.

(1) Extraordinary meeting convened by the Board of directors.

The Board of directors may call an extraordinary general meeting:

- (a) On its own.
- (b) On requisition of the members.

(2) Extraordinary meeting convened by the requisitionists

Power of Company Law Board to order meeting (Sec. 186): If for any reason it is impracticable for a company to call, hold or conduct an extraordinary general meeting, the Company Law Board may call an extraordinary meeting.

II. Class Meetings

Under the Companies Act, class meetings of various kinds of shareholders and creditors are required to be held under different circumstances. Under Sec. 106, class meetings of the holders of different classes of shares are to be held if the rights attaching to these shares are to be varied.

Requisites of A Valid Meeting: A meeting can validly transact any business if the following requirements are satisfied:

1. The meeting must be duly convened by a proper authority.
2. A proper notice must be served in the prescribed manner.
3. A quorum must be present.
4. A chairman must preside.
5. Minutes of the proceedings must be kept

Resolutions

Kinds of Resolutions: There are three kinds of resolutions under the Companies Act, 1956. They are:

1. Ordinary resolutions;
2. Special resolutions; and
3. Resolutions requiring special notice

1. Ordinary resolution (Sec. 189 (1))

An ordinary resolution is a resolution passed at a general meeting of a company by a simple majority of votes (i.e., votes cast in favour of the resolution exceed votes cast against it) including the casting vote of the chairman, if any).

When is an ordinary resolution required?

Ordinary resolution is necessary for the following among other purposes:

- a) Rectification of name or adoption of new name by a company where it resembles the name of an existing company with the previous approval of the Central Government [Sec. 22 (1) (a)].
- b) Issue of shares at a discount [Sec. 79 (2)]
- c) Alteration of share capital [Sec. 94 (2)].
- d) Re-issue of redeemed debentures (Sec.121).
- e) Adoption of statutory report (Sec. 165).

- f) Passing of annual accounts and balance sheet, along with reports of Board of directors and auditors (Sec. 210).
- g) Appointment of auditors and fixation of their remuneration [Sec. 224 (1)].
- h) Appointment of first directors who are liable to retire by rotation [Sec. 255 (1)].
- i) Increase or reduction in the number of directors within the limit fixed by the Articles (Sec. 258).
- j) Appointment of managing/whole-time director (Sec. 269).
- k) Removal of a director and appointment of a director in his place [Sec. 284(1)].
- l) Approval of appointment of sole-selling agents (Sec. 294).
- m) Winding up a company voluntarily in certain events [Sec. 484 (1) (a)].
- n) Appointment and fixation of remuneration of liquidators in a member's voluntary winding up [Sec. 490 (1)].
- o) Nomination of a liquidator in a creditors' voluntary winding up [Sec. 502 (1)].

2. Special resolution [Sec. 189 (2)]: A special resolution is one which satisfies the following conditions:

- a) The intention to propose the resolution as a special resolution has been duly specified in the notice calling the general meeting.
- b) The notice has been duly given of the general meeting.
- c) The votes cast in favour of the resolution by members entitled to vote are not less than 3 times the number of votes cast against the resolution by members so entitled and voting.
- d) An explanatory statement setting out all material facts concerning the subject-matter of the special resolution including, in particular, the nature of the concern or interest of every director and the manager, if any, shall be annexed to the notice of the meeting.

When is a special resolution required? Special resolution is necessary for the following among other purposes:

- (a) Alteration of Memorandum for changing the place of registered office from one state to another with the leave of the Company Law Board [Sec. 17(1) and (2)]. Special resolution is also required for changing the 'objects clause' of the Memorandum.
- (b) Changes of name of a company with the consent of the Central Government (Sec. 21).
- (c) Omission or addition of the word 'Private' from or to the name of a company (Sec. 21).
- (d) Change of name of a charitable or other non-profit company by omitting the word or words 'Limited' or 'Private Limited' [Sec. 25 (3)].
- (e) Alteration of the Articles of a company [Sec. 31(1)].
- (f) Conversion of any portion of the uncalled capital into reserve capital (Sec. 99).
- (g) Reduction of share capital [Sec. 100 (1)].
- (h) Variation of shareholder's rights (Sec. 106).

- (i) Removal of a company's registered office outside the local limits of any city, town or village [Sec. 146 (2)].
- (j) Keeping registers and returns at a place other than the registered office [Sec. 163(1)].
- (k) Payment of interest out of capital [Sec. 208 (2) and (3)].
- (l) Applying to the Central Government for appointing an Inspector for investigating a company's affairs in some cases [Sec. 237 (a)].
- (m) Appointment of sole selling or buying agent in the case of companies having paid-up share capital of Rs. 50 lakhs or more [Sec. 294-AA(3)].
- (n) Fixing the remuneration of directors where the Articles require such resolution [Sec. 309 (1)].
- (o) Allowing a director to hold an office of profit under a company [Sec. 314(1) and (1-B)].
- (p) Alteration of Memorandum to render the liability of directors' unlimited [Sec.323 (1)].
- (q) Applying to the Court to wind up a company [Sec. 433 (a)].
- (r) Winding up a company voluntarily [Sec. 484 (1) (b)].
- (s) Authorizing the liquidator of a company to accept shares as consideration for the transfer of its assets [Sec. 494 (1)].
- (t) Disposal of books and papers of a company in voluntary winding up when its affairs' have been completely wound up [Sec. 550 (1) (b)].

3. Resolutions requiring a special notice (Sec. 190)

A resolution requiring a special notice is not an independent class of resolutions. It is only a different kind of an ordinary resolution of which notice of the intention to move a resolution has to be given to the company. The notice shall be given not less than 14 days before the meeting at which the resolution is to be served and the day of the meeting.

9.4 ACCOUNTS, AUDIT AND PREVENTION OF OPPRESSION AND MIS MANAGEMENT

ACCOUNTS: Books of account to be kept by company (Sec. 209): The Act requires every company to maintain at its registered office proper books of account with respect to:

- a) All receipts and disbursements of money and the matters in respect of which the receipts and disbursements take place;
- b) All sales and purchases of goods of the company;
- c) The assets and liabilities of the company, and
- d) In the case of a company engaged in production, processing, manufacturing or mining activities, such particulars relating to utilization of material or labour or to other items of cost as may be prescribed by the Central Government in the case of such class of companies. The object of this clause is to make efficiency audit possible.

Inspection of books of account (Sec. 209-A): The books of account and other books and papers shall be open to inspection during business hours:

- a) By the Registrar;
- b) By such other officer of the Government as may be authorized by the Central Government in this behalf.
- c) By such officers of the Securities and Exchange Board of India as may be authorized by it.

Statutory Books: In addition to the books of account required to be maintained by a company under Sec. 209, the company is also required to maintain some other books with a view to safeguarding the interest of shareholder. Such books are called statutory books and are as follows:

- a) Register of investments not held in company's name (open to inspection of members and debenture-holders) [Sec. 49 (7)].
- b) Register of charges (open to inspection of all) [Sec.143 (1)].
- c) Register of members (open to inspection of all) (Sec. 150 (1)).
- d) Index of members where their number is more than 50 (open to inspection of all) [Sec. 151 (1)].
- e) Register of debenture-holders (open to inspection of all) [Sec. 152 (1)].
- f) Index of debenture-holders where their number is more than 50 (open to inspection of all) [Sec. 152 (2)].
- g) Foreign register (and a duplicate) of members and debenture-holders, if any (open to inspection of all) (Sec. 158).
- h) Minute books containing minutes of proceedings of general meetings (open to inspection of members) [Sec. 193] (1)].
- i) Books of account and annual accounts [Sec. 209 (1) 210].
- j) Register of contracts, and companies and firms in which directors are interested (open to inspection of members) [Sec. 301 (1)].
- k) Register of directors, managing director, manager and secretary (open to inspection of all) [Sec. 303 (1)].
- l) Register of directors' shareholding (open to inspection of members and debenture-holders during 14 days before and 3 days after the annual general meeting and to the Registrar and the Central Government) [Sec. 307 (1)].
- m) Register of loans made, guarantees given or securities provided to companies under the same management (open to inspection of all) [Sec. 370 (1.C)]

Statistical Books: In addition to statutory books, there are many other books which are required to be maintained for the proper and efficient running of a company. These books are not only found to be desirable but often indispensable in practice. Some of the important statistical or non-statutory books are as follow:

1. Share application and allotment book.
2. Share call book.
3. Register of share warrants.

4. Register of share certificates.
5. Register of share transfers.
6. Register of lost share certificates.
7. Register of balance tickets issued.
8. Register of transfers certified.
9. Agenda book.
10. Register of lists of dividends.
11. Dividend Mandates register.
12. Register of debenture interest.
13. Register of documents sealed.
14. Register of powers of attorney.
15. Register of probates.
16. Register of directors' attendance

Auditors: To safeguard the interest of the shareholders, the Companies Act provides for the employment of an auditor. The auditor is the servant of the shareholders and his duty is to examine the affairs of the company on their behalf at the end of a year and report to them what he has found.

Qualifications and Disqualifications of Auditors (sec. 226)

Qualifications [Sec. 226 (1)]: A person shall not be qualified for appointment as auditor of a company unless he is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949.

Disqualifications (Sec. 226 (3)]: The following persons, even if they are otherwise qualified, shall be disqualified from being appointed as auditors of a company:

- a) A body corporate.
- b) An officer or employee of the company.
- c) A person who is a partner, or who is in the employment of an officer or employee of the company.
- d) A person who is indebted to the company for an amount exceeding Rs. 1,000 or who has given any guarantee of any third person to the company for an amount exceeding Rs. 1,000.
- e) A person holding any security of that company after a period of one year from the date of commencement of the Companies (Amendment) Act, 2000.

Appointment of Auditors (Sec. 224 and 225): Appointment in annual general meeting: Every company shall, at each annual general meeting, appoint an auditor or auditors to hold office from the conclusion.

Restriction on the Appointment of Auditors: A company shall not appoint or re-appoint any person who is in full-time employment elsewhere or firm as its auditor if such person or firm is, at the date of such appointment or reappointment, holding appointment as auditor of more than the specified number of companies.

Compulsory re-appointment: At any general meeting a retiring auditor, by whatsoever authority appointed (Board of directors, general meeting, annual general meeting or Central Government), shall be re-appointed except in the following cases:

- a) If he is not qualified for re-appointment;
- b) If he has given notice to the company in writing or his unwillingness to be re-appointed;
- c) If a resolution has been passed to the effect appointing somebody instead of him or providing expressly that he shall not be re-appointed; or
- d) Where notice has been given of an intended resolution to appoint some person or persons in the place of a retiring auditor, and by reason of death, incapacity or disqualification of that person or of all those persons, the resolution cannot be proceeded with [Sec. 224 (2)]

Appointment by the Central Government: Where at an annual general meeting no auditors are appointed or re-appointed, the Central Government may appoint a person to fill the vacancy. Appointment of auditors by a special resolution: Sec. 224-A puts another restriction that in the case of a company in which not less than 25 per cent of the subscribed share capital is held, whether singly or in any combination, the appointment or re-appointment at each annual general meeting of an auditor or auditors shall be made by a special resolution.

First auditors: The first auditors of a company shall be appointed by its Board of directors within 1 month of its incorporation.

Subsequent appointment (Sec. 225): At the expiry of the term of an auditor, the members may, in the annual general meeting, appoint another person in his place.

Penalty (Sec. 232): If default is made by a company in complying with any of the provisions of Sec. 225, the company, and every officer of the company who is in default, shall be punishable with fine which may extend to Rs. 5,000.

Casual vacancy: The Board of directors may fill any casual vacancy in the office of an auditor.

Removal of auditors: The first auditors of company appointed by the directors prior to the first annual general meeting of the company may be removed by the members in a general meeting even if their tenure of office has not expired.

Remuneration of auditors: The remuneration of the auditors of a company shall be fixed by the company in general meeting or in such manner as the company in general meeting may determine.

Position of Auditors: 1.As agent of the members. 2.As officer of the company and 3.As employee of the company

Rights and Powers of Auditors

1. Right of access to books accounts and vouchers (Sec. 227).
2. Right to obtain information and explanations (Sec. 227)
3. Right to visit branch offices and right of access to books, etc. (Sec. 228)
4. Where the accounts of any branch office are audited by a person other than the company's auditor, the company auditor shall –

5. Be entitled to visit the branch office, if he deems it necessary to do so, for the performance of his duties as auditor; and
6. Have a right of access at all times to the books and accounts and vouchers of the company maintained at the branch office.
7. Right to receive notice of general meeting and to attend them (Sec. 231)
8. Right to receive remuneration.

Duties of auditors:

1. Acquaintance with the Articles and the Companies Act.
2. Report to members (Sec. 227).
3. Duty of care and caution.

Further duties:

1. Statutory report (Sec. 165)
2. Prospectus (Sec. 56).
3. Assistance in investigation (Sec. 240).

Prevention of Oppression and Mismanagement

Special powers have been vested in the Company Law Board for the protection of members against oppression by the majority of shareholders and for intervention in case of mismanagement of a company's affairs. This has been done because the cardinal rule laid down in *Foss v. Harbottle* that the minority is bound by the decision of the majority, is abused in many cases. Sec. 397 and 409 provide for remedial measures. If the oppressed minority considers that to wind up the company would not relieve but on the contrary, they would be unfairly prejudiced by winding up, they may petition the Court under Sec. 397, and the Court may impose a solution on the disputants. A certain number of members (stated below) may apply to the Company Law Board for relief on the grounds that the affairs of the company are being conducted:

1. In a manner oppressive to any member or members, or
2. In a manner prejudicial to the interests of the company, or
3. In a manner prejudicial to the public interest, or
4. That material change has taken place in the management or control of the company and that by reason of, it may pass any orders with a view to bringing to an end the matters complained of, or apprehended.

If the Company Law Board is satisfied that the affairs of the company are being conducted as complained of, it may pass any order with a view to bringing to an end the matter complained of, or apprehended. The number of members necessary to make application is

- a) in the case of a company having share capital, 100 members or 10 per cent of the total number of member, whichever is less, or members holding 10 per cent of the issued capital;

- b) In the case of a company not having share capital, 20 per cent of its total number of members. The Central Government is also entitled to apply to the Company Law Board for an order as above.

The Company Law Board may in its discretion make any order that it thinks fit, and in particular, it may provide for:

- a) The regulation of the company's affairs in future, and may even frame fresh regulation;
- b) The acquisition of the shares or interests of any members by other members or by the company;
- c) The consequent reduction of the share capital in case of b) above;
- d) Termination, setting aside or modification of any agreement, howsoever arrived at, between the company and the managing agent, secretaries and treasurers, managing director, any other director, or manager;
- e) Termination, setting aside or modification of any agreement between the company and any other person with the latter's consent;
- f) Setting aside any transfer, delivery of goods, payment, execution or other act relating to property made or done by or against the company within 3 months of the application which would amount to a fraudulent preference in the case of an individual's insolvency;
- g) Any other matter for which in the opinion of the Company Law Board it is just and equitable that provision should be made (Sec. 402). No compensation is payable for loss of office resulting from the termination of agreement by the Company Law Board. Any person whose agreement of office has been terminated cannot act for the company for 5 years thereafter without the leave of the Company Law Board. In addition to the above order, heavy penalties are provided.

9.5 WINDING UP

Winding Up by Court: A winding up by the Court, or compulsory winding up, as it is often called, is initiated by an application by way of petition presented to the appropriate Court for winding up order.

Grounds for Compulsory Winding Up:

- a) Resolved to be wound up by the Court.
- b) If default is made in delivering the statutory report to the Registrar or in holding the statutory meeting.
- c) If the company does not commence its business within a year from its incorporation, or suspends its business for a whole year.
- d) If the number of members falls below seven (or in case of a private company, below two).

- e) If the company is unable to pay its debts.
- f) If the court is of opinion that it is just and equitable that the company should be wound up.
- g) Just & Equitable:
 - (i) Main object-failed;
 - (ii) Deadlock in management
 - (iii) Cannot carry on business except losses.
 - (iv) Mere bubble – and does not carry any business or does not have any property.
 - (v) Majority of shareholder have adapted an aggressive policy towards the minority.

Who may Petition: The following persons may file petition: (1) the company; (2) creditor; (3) contributory; (4) all or any of the above parties; (5) the Registrar; (6) any person authorized by the Central Government (7) by virtue of Sec. 440, when a company is already being wound up voluntarily, the court may order winding up by it.

Voluntary Winding Up: A company may be wound up voluntarily: (i) when the period (if any) fixed for its duration has expired or an event on the happening of which the company is to be wound up has happened and the company in general meeting has passed an ordinary resolution to wind up; or (ii) if the company passes a special resolution to wind up voluntarily (Sec. 484). There are two kinds of voluntary winding up, namely: **Member's** or **Creditors'**.

Winding Up Under Supervision: Where a company is being wound up voluntarily the Court may order the continuation of voluntary winding up subject to its supervision with any terms or conditions. The liquidator will continue to exercise all powers subject to any restrictions laid down by the Court.

Consequences of Winding Up

As to Shareholders: A shareholder is liable to pay full amount of shares held by him.

As to Creditors: A secured creditor may either (i) rely on the security and ignore the liquidation, or (ii) value his security and prove for the balance of his debt, or (iii) give up his security and prove for the whole amount. Unsecured creditors of an insolvent company are paid in this order: (i) preferential payment under Sec.530, (ii) other debts **pari passu**.

As to Servants and Officers: A winding up order operates as a notice of discharge to the employees and officers of the company except when the business of the company is being continued (Sec. 444). A voluntary winding up also operates as a notice of discharge.

As to Proceedings: After a winding up petition is presented the Court may stay all proceedings against the company.

As to Costs: If the company, while in liquidation, brings or defends any action and is ordered to pay costs, they are paid first out of the assets of the company.

Offences Antecedent To or In Course of Winding up Offences of Officers:

Every past and present officer of a company which is being wound up must assist the liquidator and if he fails to do so he is liable to be punished. He is liable to be imprisoned up to 5 years, or fined or given both punishments.

Misfeasance Proceedings: In the course of winding up a company it appears that any person who has been guilty of any misfeasance or breach of trust in relation to the company, the Court may, examine into the conduct of the person, director, managing agent, secretaries and treasurers, manager, liquidator or officer aforesaid, and compel him to repay or restore the money or property or any part thereof respectively with interest at such rate as the Court thinks just, or to contribute such sum to the assets of the company by way of compensation, notwithstanding that offence is one for which the offender may be criminally liable.

Liquidators

Compulsory Winding Up: The official Liquidator attached to each High Court will become the liquidator on a winding up order being passed.

Powers of Liquidator: (i) institute or defend any suit, prosecution, or the legal proceeding in the name of the company, (ii) carry on the business of the company for its beneficial winding up, (iii) sell company's property, (iv) raise money on the security of the company's assets, and (v) do all other things necessary for the winding up.

Duties of Liquidator: Summon meetings of creditors or contributories get in the property and pay the debts and distribute the balance among contributories. Keep the proper books of account, minutes books, and allow inspection thereof. Keep all the funds of the company in "the public account of India" in the Reserve Bank of India.

Voluntary Liquidator: The voluntary liquidator is appointed by resolution in general meeting of the company and or of the creditors and his remuneration fixed. A voluntary liquidator is a paid agent of the company and is liable in damages if he neglects his duties as such.

Disclaimer by a Liquidator: Section 535(1) empowers the liquidator, with the leave of the Court to disclaim any onerous property of the company.

9.6 REVIEW QUESTIONS

1. “A company has an identity separate from its members” – Explain the statement critically.
2. What do you mean by Articles of Association? What are the effects of Articles? Can Articles be altered?
3. State the important consequences of MIS-Statement in the prospectus.
4. Distinguish between a share and a stock.
5. What is a statutory meeting? What is the nature, scope and extension of business to be transacted at such meeting?
6. Discuss the duties of the Directors and their liabilities to the company and third parties.
7. What are the powers of the court in relation to the prevention of oppression and MIS-management?
8. State the grounds on which court can order winding up of a company.
9. What are the characteristic features and classes of debentures?
10. Explain the statutory and statistical books that are to be maintained by a company.

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