

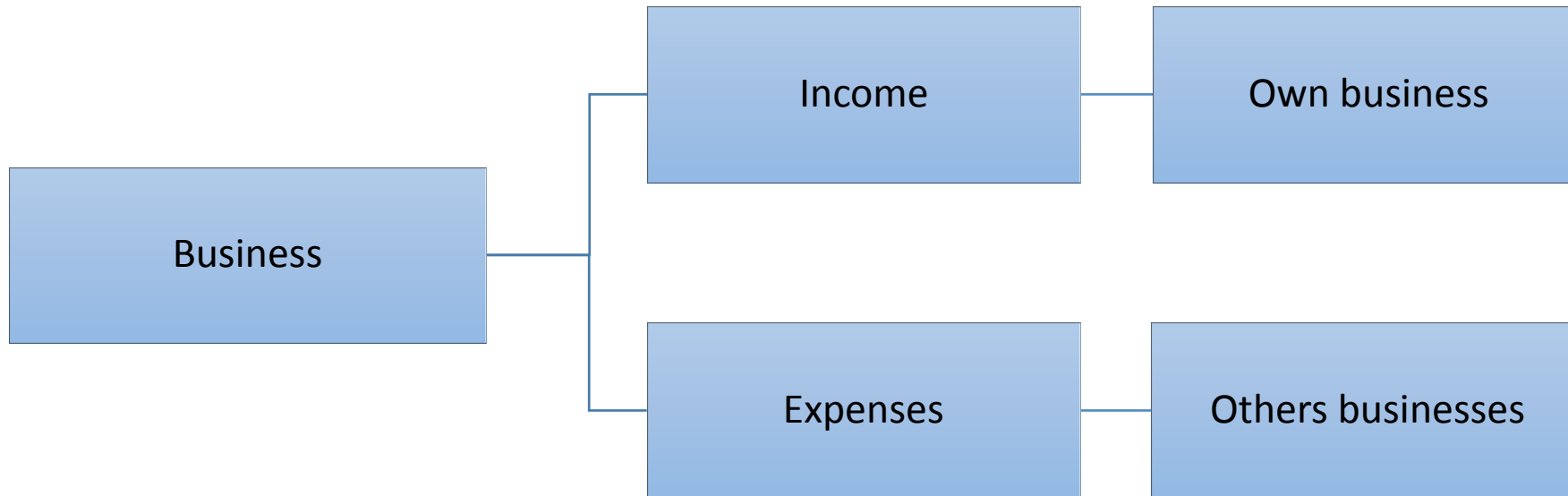
# Chapter 1 : BUSINESS & COMMERCIAL KNOWLEDGE - INTRODUCTION

CA Foundation Course

Paper 4B – Business & Commercial Knowledge

# Introduction:

- Business → Any activity which is done to earn profits.



# Domains of BCK:

## Activities

- Manufacturing, Trading (Domestic, Foreign), Commerce (Aids to Trade or Auxiliaries to Trade) Services

## Scale

- Micro Enterprises, Small Enterprises, Medium Enterprises , Large Enterprises

## Geographic Scope

- Local, National, Multinational

## Ownership

- State owned/ Public Sector, Private Sector (Sole Proprietorship, Partnership, Company/ Corporate Sector)

## Markets

- [Natural] Resources, Equipment's, Commodities, Capital, Labour, Product Markets

## Stakeholders

- Entrepreneurs, Promoters, Customers, Investors, Business Owners, Directors, Shareholders, Managers, Employees, Suppliers, Laws & Regulators/Policy makers, Supporting / Facilitating Organizations, Society

## Functions

- Production/ Operations, Marketing, Accounting Finance & Taxation, Human Resource

## Focus

- Company/ Enterprise wide, A particular business line, A particular function

## Concerns

- Survival, Profitability, Growth, Sustainability, Social Responsibilities, Governance, Values & Ethics

## Mode

- Traditional/ Physical/ Brick & Mortar/In-store, Digital/ Online

## Underlying Discipline

- Economics, Laws, Philosophy, Psychology, Sociology

# Business Quotient:

- Business quotient basically means the characteristics of a business.
- Self Assurance
- Non commerce background is not a handicap
- Observation and experience are the best guides
- Six honest servants by Rudyard Kipling (an English journalist)
- Practice and Improvement via reflective thinking leads to perfection

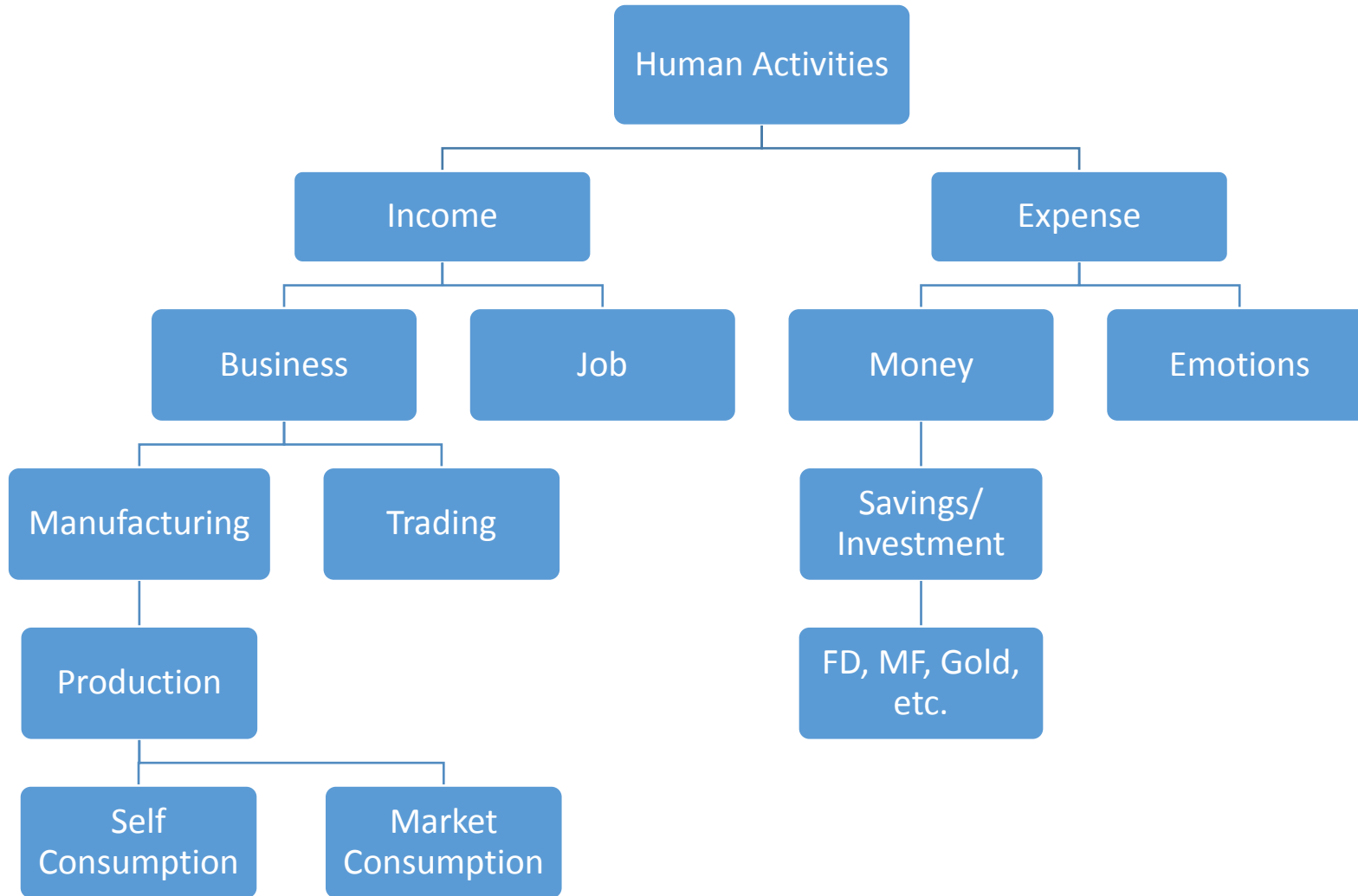
**paytm**



**Flipkart**



# Human Activities:



# Definitions of Business:

- **Broader:**

- From the broader perspective business may be defined as an economic activity comprising the entire spectrum of activities pertaining to production, distribution and trading (exchange) of goods and services.

- **Medium:**

- From the medium perspective, business refers to a particular type of activity or industry such as Retail Business, Real Estate Business, and IT Business, Iron & Steel Industry, Transport Business, etc.

- **Narrow:**

- From a narrow perspective business may be defined as one's usual occupation of creating, owning and actively operating an economic organization i.e., a firm.

# Income Tax Act, 1961:

- Five heads of Income:
  - Income from Salary
  - Income from House property
  - Income from Business & Profession
  - Capital Gains
  - Income from Other sources
  
- Agriculture: A Business or not?
  - As per Chartered Accountants, agriculture is **NOT** a business
  - It is exempted from Tax.
  - If any agricultural product is used to make another product then that **IS A** business activity.

# Distinction between Business Profession & Employment:

| S. No. | Basis of distinction                         | Business   | Profession  | Employment   |
|--------|--|--|---|--|
| 1      | Meaning                                      | Entire spectrum of market oriented activities coming under industry, trade and commerce. | Independent rendering of services of specialized nature based on prescribed qualifications under the aegis of a professional body that also prescribes a code of conduct. | Rendering of services under a contract of employment for wages / salaries.<br>Also, called wage- employment. |
| 2      | Mode of establishment                        | Entrepreneur's decision and other legal formalities, if necessary                        | Membership of a professional body and certificate of practice.  | Letter of Appointment and service agreement.   |
| 3      | Source of livelihood                         | Profit   | Professional Fee.   | Wages & Salaries.  |
| 4      | Prescribed qualifications                    | None   | Strictly prescribed   | Minimum qualifications for each type of job  |
| 5      | Ethical guidance                             | Founder's values   | Professional codes  | Employer's codes   |
| 6      | Investment                                   | Substantial requirement  | Some requirement<br>e.g. Office/ Chamber / Clinic   | None   |
| 7      | Personal autonomy / freedom                  | The most- you are your own boss  | Quite a bit   | Not much   |
| 8      | Popular psychological motive                 | Economic achievement   | Service to the clients/ society   | Livelihood   |
| 9      | Certainty of income                          | Least. However either way.   | Quite a bit   | The most. Contractually determined periodic income   |
| 10     | Stability of tenure/Durability of Occupation | Uncertain  | Quite certain   | Quite certain  |
| 11     | Transfer of interest/ succession             | Possible   | Not possible  | Not possible   |



# How is Business different?

- It is a job creator and not a job seeker.
  - Provides momentum to economic growth and development.
  - Investment intensive.
  - Gestation and Uncertainties.
  - Systematic, organized, efficiency oriented activity.
  - Objective oriented/purposeful.
- 
- A businessman is an individual who operates or starts a business with the same old business idea.
  - An entrepreneur is an individual with an exclusive idea to initiate and establish a new venture.



# Objectives of Business:

| Economic   | Organic  | Social   | Legal/ Ethical/<br>Environmental   |
|--|--|--|--|
| <p>Sales, profits, return on investment, efficiency (resource conservation, achieving more from less) economic value added (profits in excess of cost of capital invested in business), market share</p> | <p>Survival, health (age of assets, fitness of human resources, reserves-capital, general and contingency) growth, diversification of capabilities</p> | <p>Community service, education, health, sanitation, heritage conservation, community support during calamities &amp; disasters, etc.<br/>Specific responsibilities toward employees, investors, customers, suppliers, competitors, etc.</p> | <p>Respect for law in letter and spirit, fair practices, transparency, truthfulness, honesty &amp; integrity. Green technologies, products-usage &amp; disposal, lower emissions, effective waste handling and disposal, preservation of air, water and soil quality</p> |

# Forms of Business Organization:

- There are various forms of organizations in India that depend on their ownership which are classified as:
  - Sole Proprietorship
  - Joint Hindu Undivided Family Business
  - Partnership
  - Limited Liability Partnership (LLP)
  - Company

# Sole Proprietorship:

## ■ Features of a Sole Proprietorship Business:

|  |  |
|--|--|
| <b>Autonomy of being one's own boss</b>                  | <b>Merit.</b> Because of freedom from the restrictions of paid employment. Ample scope for experimentation and expression of one's creativity and innovativeness.  |
| <b>Sole provider of capital</b>                          | <b>Limitation.</b> This limits the size of business. Yes, banks and lenders may provide additional resources. However, borrowing capacity too is determined by capital adequacy. This feature also limits the capacity to grow.  |
| <b>Visibility of the owner and personalised services</b> | <b>Merit.</b> For example, the personal rapport with the customers engenders trust and loyalty.  |
| <b>Sole bearer of risks</b>                              | <b>Limitation.</b> This arises from being the sole provider of capital. If all the profits belong to her, so do the losses.  |
| <b>Unlimited liability</b>                               | <b>Limitation.</b> It is a common limitation of proprietary forms of business organizations. In the event of insolvency i.e. Liabilities > Assets, the owners' personal assets are invoked to make up the deficit.   |
| <b>Fate as a going concern</b>                           | <b>Limitation.</b> Sole proprietary entities going concern status depends on the owner's personal health and life span. And, after his death upon the willingness and the ability of the heirs/successors in the family.   |
| <b>Succession of ownership</b>                           | <b>By will</b> [aka. Testament] or application of the law of inheritance. A will or testament is a legal document by which a person, the testator, expresses their wishes as to how their property is to be distributed at death, and names one or more persons, the executor, to manage the estate until its final distribution. If the will is non-existent [i.e. for intestate succession] the applicable law of inheritance will come into force. For example, for the Hindus, Parsis, Buddhists, Jains and Sikhs, The Hindu Succession Act, 1956 is applicable. |

# Joint Hindu Undivided Family Business:

## ■ Features of a Joint Hindu Undivided Family Business:

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|--|--|
| <b>Formed by birth in a Hindu (Buddhist, Jain and Sikh) family</b>                   | <b>Merit.</b> Family members may naturally join each other in business. In contrast, in a Muslim family if the siblings wish to associate in a business, they will have to do it contractually e.g. Partnership Agreement  |
| <b>Family pool of resources</b>  | <b>Merit.</b> It is possible to start / expand a large business. Moreover, the common pool of capital may be utilized to diversify business in sync with the aspirations of the members of the successive generations of the family.   |
| <b>Social capital through family involvement</b>                                     | <b>Merit.</b> There is an instant trust among the family members as compared with the situation of partnership with strangers. Family members toil hard to build the family business. Moreover, they may specialize in different business functions for greater complementarity of the mutual skills.  |
| <b>The family members are the automatic co-owners (called co-parceners) by birth</b> | <b>Limitation.</b> Ownership in family business is an ascribed rather than earned status. It can actually be quite frustrating for the outsiders e.g., hired managers who help build the business  |
| <b>Decision making is quick</b>  | <b>Merit.</b> In the absence of other active major members of the family, the head of the family known as Karta takes all the decisions. Subsequently decisions are taken by and in the family. Prevalence of mutual trust, informality of communication makes decision-making quick.  |
| <b>Unlimited liability of the Karta</b>  | <b>Limitation.</b> It is a common limitation of proprietary forms of business organizations. In the event of insolvency i.e., Liabilities > Assets, the owner's (here the Karta) personal assets are invoked to make up the deficit. However, the liability of the other family members is limited to the extent of their share in the co-parcenary. |
| <b>Fate as a going concern</b>   | <b>Limitation.</b> Few family businesses last beyond third generation. Often family feuds result in business splits.   |
| <b>Succession of ownership</b>   | Same as sole proprietorship.   |

# Partnership:

## ■ Features of a Partnership:

|                                   |   |
|-----------------------------------|---|
| <b>Agreement</b>                  | <b>Merit.</b> The agreement makes possible co ownership of business by persons who do not share a common ancestry of a family.  |
| <b>Two or more persons</b>        | <b>Merit.</b> Partnership allows raising of funds beyond the resources of an individual / sole proprietor. In fact, even a company, being an artificial person can be admitted as a partner!<br><b>Limitation.</b> There is a cap on the maximum number of persons. It is 10 for a banking firm and 20 for other firms. |
| <b>Profit sharing</b>             | <b>Merit.</b> For there is risk sharing too. However, whilst profit sharing is an essential feature of partnership, loss sharing is not. Certain partners may be admitted only in the profits of the firm e.g. minor partners.  |
| <b>Business object quite wide</b> | <b>Merit.</b> A partnership cannot be formed for non-business purpose. However, the word business here includes every trade, occupation and profession. For example, many accounting/ auditing and legal firms are organized as partnership firms.  |
| <b>Mutual agency</b>              | <b>Merit.</b> Mutual agency – that is one for each other and for all ensures that all the partners work in the common interest and in the interest of the firm.<br><b>Limitation.</b> A partner's misdeeds impact all the partners and the fate of the firm.  |
| <b>Unlimited liability</b>        | <b>Limitation.</b> It is a common limitation of proprietary forms of business organizations. In the event of insolvency i.e. Liabilities > Assets, the partners' personal assets are invoked to make up the deficit. Owing to the mutual agency, the liability of all the partners is both joint and several.           |
| <b>Fate as a going concern</b>    | <b>Limitation.</b> Since partnership arises out of contract, it also ceases in the same way. A partner may serve a notice of severance to the firm and the partnership comes to an end.   |
| <b>Succession of ownership</b>    | <b>Limitation.</b> Ownership is not easily transferable. A new partner can be admitted only if other partners consent.  |

# Limited Liability Partnership (LLP):

## ■ Features of a Limited Liability Partnership (LLP):

|  |   |   |
|--|---|---|
| <b>Limited liability. No personal liability of partner, except in case of fraud.</b> | Unlimited personal liability of each partner for dues of the partnership firm. Personal assets of each partner also liable. | <b>Merit.</b> This does away with a major limitation of traditional partnership   |
| <b>Incorporation is mandatory.</b>   | Partnership is registered under partnership Act. Registration is not mandatory.   | <b>Merit.</b> The mandatory registration brings the firm under the regulatory purview of the Ministry of Corporate Affairs. This increases its credibility.                   |
| <b>It is a legal entity separate from its partners.</b>                              | Not a legal entity separate from its partners.  | <b>Merit.</b> This does away with the uncertainty of the firm's existence as a going concern.   |
| <b>Minimum 2 and no limit on maximum number of partners.</b>                         | Minimum 2 and maximum 20 partners   | <b>Merit.</b> The upper limit in the traditional partnership restricted the scope of business and future expansion plans.   |
| <b>ROC is the administrating authority.</b>  | The registrar of firms (of respective states) is the administering authority  | <b>Merit.</b> There is body to control that brings credibility in the eyes of stakeholders.   |
| <b>Statutory compliances</b>   | Not many  | <b>Limitation.</b> Designated partners to ensure the compliances. However, in comparison with the companies, the compliances are fewer and simpler.                           |
| <b>Every partner of LLP is only agent of firm</b>                                    | Every partner of firm is agent of firm and also of other partners   | <b>Merit.</b> Absence of mutual agency enhances freedom at one hand; and, on the other hand frees the other partners of the burden of responsibility of the acts of a Partner |

# Company:

## ■ Features of a Company:

|  |  |   |
|--|--|---|
| <b>Minimum number of members: 02</b>   | 07   | Lower number of minimum members too eases of formation  |
| <b>Maximum number of members: 200</b>  | No limit   | No upper limit on the members of public company puts on its disposal enormous funds.  |
| <b>There are restrictions on transfer of shares</b>  | The shares may be freely tradable on stock exchange via listing  | Listing of the shares of a public company adds to their liquidity so that the investors may encash the shares whenever needed   |
| <b>Minimum number of directors: 02</b>   | 03   | Not of much consequence. Smaller board size adds to the internal efficiencies.  |
| <b>Private companies are exempted from constituting such committees of the Board of Directors as Audit Committee, CSR Committee, Stakeholder Committee and the Nomination and Remuneration Committee</b> | These committees are to be mandatorily constituted   | More liberal a governance regimen of private companies exists because common man's money is not on stake in their share capital   |
| <b>It can start business upon incorporation</b>  | A public limited company is required to obtain Certificate of Commencement of Business in addition to the Certificate of Incorporation | Fewer formalities add to the attractiveness of private limited companies, more so corporatization of proprietary concerns e.g. partnership firms. Albeit, now there is also an option for the partnership firms to convert to LLP |