UNIT 3 CORPORATE FORMS IN TOURISM

Structure

3.0 OBJECTIVES

After reading this Unit you would be able to:

- describe the features of the main business forms, like sole proprietorship, partnership, company, etc.
- know the advantages and disadvantages of these business forms, and
- appreciate the features of each business form.

3.1 INTRODUCTION

In TS-1 **Unit** 5 we **discussed** the various segments of the tourism industry **alongwith** different types of services. You are also aware that tourism facilities and services are provided by a variety of organisations with different types of ownership. These include both, Public Sector as well as Private Sector Organisations. Besides, in this sector, profit oriented and non-profit oriented organisations also co-exist. Apart from organisations there are people who provide tourism services and facilitiesin individual capacities or in groups. In fact, in each sector of tourism you come across enterprises of **all** sizes and forms. Such adiversity of corporate forms is hardly seen in other industries. Here you must remember that **the functions of all enterprises in tourism are aimed at transforming available resources into tourism products i.e. services, attractions and facilities.** These enterprises or business forms are influenced by a variety of factors like financial resources, taxation regulations and constraints, management skills, personal objectives and motivation etc. of all those involved in planning, developing or operations.

This Unit deals with the principal business forms. How these business forms differ from each other is another aspect dealt within the unit. Besides **this,** the main advantages as well as disadvantages of each business form are also discussed. The Unit begins with a brief description of the concepts of market, service and industry.

3.2 SERVICE, MARKET AND INDUSTRY.

The basic act in social growth and progress has been production for survival and development.

One of the important ways in which societies can be classified is according to the way the production process is organised and the way commodities are exchanged. This brings us to a new term, commodity. What does this mean and how is it different from a good?

Well, a good is a thing which gives us some satisfaction or utility when we use it or consume it. Your food, clothes, books are all goods. **What distinguishes a commodity from a good is that a commodity is that good which is produced for exchange, that is, to be bought and sold.** Let us give an example. Suppose you have a kitchen garden in your backyard. Here you grow some vegetables for your own consumption. These vegetables are goods and they give you utility but **they are not commodities because they were not produced for sale in the market. They become commodities only if you produce them for sale.**

3.2.1 Service

Is it only goods which can be commodities? The answer is that apart from goods, services can also be commodities. For example, when you drive your own car for personal work your driving is not a commodity. But when you drive it on payment basis you sell your driving as a service and it becomes a commodity. Services are intangible and the tourism products by and large are services which are consumed in the process of their production.

3.2.2 Market

Buying and selling of goods and services and production of goods and services for exchange is the hallmark of the market system of production and exchange. Here, market is not what we understand by its everyday meaning as a place where goods are bought or sold. Rather, it is, an abstract term which seeks to denote a system **which is organised in a way where goods are produced, sold and distributed by voluntary exchange between people.** In contrast is the production and distribution through what is called command, that is controlled by the State or the Government. We can speak of the market for a specific commodity, for example, the market for tour packages or the market for hotels. Among the components of a market on the one side are the suppliers or sellers which include the producers, merchants, retailers, franchisers, etc. On the other hand are the buyers, i.e. the consumers of the goods and services. The consumers have a demand for the goods or services and the sellers supply the goods and services. These forces of demand and supply are what drive the market system or the market. The main device here is the price of the goods and services. Prices of commodities are the most important 'signals' which convey information to buyers and sellers about how'much to sell and buy.

Usually, sellers will supply more, other things remaining the same, if the price of a commodity goes up, because they expect to earn more. Buyers, on the other hand, will buy less of a commodity, other things remaining the same, if the price of the good rises because they find it more expensive. For example, if airline tickets were to cost more suddenly, people might travel less by air. At any given price, if supply exceeds demand, prices tend to fall. On the other hand, at any given price, if demand exceeds supply, there is an upward pressure on prices. Because of the pivotal role of prices, the market system is also called the price mechanism.

3.2.3 Industry

In TS-1 Block 2, we discussed Tourism as an Industry. Let us once again clarify the meaning of the term industry. When we use the word 'industry' we think of some scientific or engineering process of production. We limit our discussion to sectors like 'iron and steel', chemical industries, etc. However, for our purposes, the term 'industry' has more general connotations. Industry is taken to mean the totality of production of a particular good or service. Thus, there may be several different firms or companies manufacturing motor cars but for all the cars in the economy, we may speak of the car industry. Similarly, different firms, individuals or groups provide tourism products and services but we use the term tourism industry for all products and suppliers of tourism products and services. Let us now discuss the main business or corporate forms.

3.3 SOLE PROPRIETORSHIP

A proprietor is'the person who owns and controls business. As the name suggests, sole proptietorship is a form of business **which is owned and controlled by one person. It is only the owner who takes the risks, mobilises resources, receives the profits or bears the losses.** Suppose you open a shop which offers crafts and art objects which the tourists buy, or you open a lodge, in this case you would be a sole proprietor. This would be in spite of your employing a sales person or a receptionist etc. **Usually,** when you hear the phrase "starting one's **own** business" you can take it to mean a sole proprietorship. In fact numerically speaking, sole proprietorship is the most common business form.

3.3.1 Salient Features

These include :

1) **Single Ownership:** There is a single person owning the business, with no partnership or co-operative structure.

2) **Personal Organisation or Common Identity**: This means that the person is the business **and** the business is the person. Unlike a company where the **firm** or the business organisation has legal entity which is separate from and independent of the owner, in sole proprietorship the person and the business 'firm' are the same. This has certain implications, such as that the person pays personal income tax on all earnings.

3) **Self Finance**: In sole proprietorship, finance is employed by the person from **his/her** own resources or by borrowing. The person cannot issue shares or bonds to raise money in the market.

4) **Profits and Losses**: In sole proprietorship, the profits accruing from the business, or the losses, if any, belong to the businessperson and are not to be shared with anyone else.

5) **Registration**: Unlike partnerships or companies, there is no special legislation which governs sole proprietorship. For Companies there is the Companies Act, for Co-operatives there is the Co-operative Societies Act and for partnership there is the Partnership Act. But there is no similar legislation for sole proprietorships.

33.2 Advantages

As compared to other business forms, sole proprietorship has several advantages:

1) **It is very easy to set up and dissolve.** The person wishing to set up a business does not have to go through complex legal and bureaucratic procedures. Usually sole proprietorship requires less capital than other business forms to set up, since its scale of operation is lower. Similarly, the business can be dissolved quickly as there are no partners or shareholders or directors whose permission is required.

2) **For decision making the owner enjoys independence and flexibility.** The owner can decide or change decisions quickly as per ones own wishes. Hence, the time lag between desire for a decision and implementing the decision can be very small.

3) **Retentions of all the profits acts as an incentive towards effort and efficiency.**

4) The sole proprietor can **respond to changes in market conditions and consumer needs quickly.** Suppose you run a souvenir shop and find that tourists have lately shown a lower preference for one kind of item and a higher preference for some other, you **can** quickly stop storing that item for which the demand has fallen and increase the quantity of that item for which the demand has gone up.

5) **In sole proprietorship business confidentiality can be maintained more successfully.**

3.3.3 Disadvantages

Sole proprietorship as a business form is not without disadvantages.. Some of the disadvantages are :

1) Since it has unlimited liability, this may inhibit risk-taking and lead to overcautious decision making. The sole proprietor should not forget that in case of a huge loss, personal assets also can be attached in order to fulfill obligations to creditors.

2) Financial capital resources are limited to the owner's money. Borrowing is there but that would be against an asset or repaying capacity (which would depend on the income or assets). This means that the scale of capital mobilised may pot be of a very high order and hence hinder the required rate of expansion in a competitive market. For example, suppose a person runs a restaurant at which tourist coaches often stop. Suppose the attraction or demand for the destination increases and more tourists visit the site. The number of tourist coaches taking a halt also increases. This demands an increase in the capacity of the restaurant (add chairs, tables, waiters, foodstuffs, fuel, etc.) to cater to the increased demand. But if current profits and income is not sufficient to make the necessary investment, the opportunity to increase sales or expand would be lost.

3) There is only the owner to provide managerial skills and this may not be adequate as the business grows. New ideas and methods may be required. Although, the sole proprietor may 'change with the times', he may still find the going rough in the absence of managerial and business skill inputs from others.

4) Sole proprietorship has another disadvantage i.e. physical illness or absence from work of the owner could adversely affect the business. Moreover, one person cannot always do everything.

Check Your Progress - 1

1) What are the main features of sole proprietorship as a business form?

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2) Discuss the main advantages of sole proprietorship.

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3) What are the principal disadvantages of sole proprietorship?

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3.4 PARTNERSHIP

Any two or more persons can get together to form a partnership for doing some business. Each may agree to provide some amount of work and capital. They also agree to share the profits. They may agree to share losses and debts. An oral agreement would suffice, but usually a proper written legal agreement is drawn up spelling out the terms and conditions.

A partnership is an association of two or more persons who operate a business, for example, a travel agency or a hotel as eo-owners under some agreement.

It may happen in some cases that a partner may take no active part in decision making or operations. In that case the partner is called a sleeping partner and has limited liability.

3.4.1 Advantages

These include :

1) A partnership as compared to a Joint Stock Company is easier to set up as there are fewer legal requirements. It is also easier to dissolve.

2) For similar reasons as mentioned for sole proprietorship, a partnership shows greater flexibility as compared to a company.

3) As compared to sole proprietorship, a partnership, because there is more than one businessman, provides for greater managerial and entrepreneurial skills to draw upon.

4) A partnership is usually able to mobilise more financial resources than a sole proprietorship, simply because there are more people to raise finance.

3.42 Disadvantages

A partnership also has disadvantages:

1) Its principal disadvantage stems from its properties of unlimited liability and legal responsibility for the action of the partners. Each partner is liable without limit to the full extent of his/her personal property or asset for all debts incurred by the partnership. Suppose a partner owns 25% per cent of the business and the business fails, then he or she will be required to return 25% of the debts and the other partners the rest of the 75%. But in case they cannot pay any part of their assessment, then he or she may be asked to pay for all partners. Legal responsibility for the action of the partners arises from the feature of "mutual agency" involved in the principle of partnership, according to which each partner has powers to act as agent, to commit the whole partnership. Hence, sometimes people are reluctant to commit their capital into enterprises over which they exercise little control.

2) Efficiency of a partnership firm may suffer if interpersonal relations among the partners go wrong.

3) An absence of consensus among partners can affect the entire business. For example one may like to expand business, others may not.

4) Interpersonal problems can lead to long term problems in continuity also.

5) It is not easy to dissolve the business as is the case in sole proprietorship.

Check Your Progress - 2

1) List the advantages of partnership.

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2) What kind of problems do you envisage in a partnership?

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3.5 THE COMPANY

The Joint Stock Company is historically the latest of the business ownership forms and is the most significant. It is by far the dominant form of business throughout the world. This holds true in tourism industry also. Airlines like Air India, Lufthansa, Tourism firms in India and India Tourism Development Corporation (ITDC) or Finance Companies like Tourism Finance Corporation of India (TFCI) are all Companies. The size of the business of a Joint Stock Company is much bigger than sole proprietorship and partnership.

3.5.1 Features

These include:

1) As a business firm, it is in itself a legal entity. Although partnerships have to function under a legal Act called the Partnership Act, a partnership is a separate legal entity only in name. The partners are jointly described as a "firm" but a partnership does not have a legal entity independent of its partners. A corporation on the other hand, is a legal entity independent of shareholders. The company is autonomous and requires incorporation.

2) The company is related to the share capital that is raised and the way the division of the share capital occurs.

3) A company is characterised by perpetual succession. The life of a company is not affected by the death, retirement, or insolvency of directors or shareholders. It must be noted here that there are certain differences between partnerships and companies:

   i) As has been mentioned more than once, a company is incorporated. A partnership, on the other hand has no legal entity of its own. Partners are jointly called firms only for convenience.

   ii) A company and its members have limited liability while a partnership has unlimited liability.

   iii) The share or interest of a partner in the business is not transferable without the consent of all co-partners. Company shares by contrast are freely transferable at the option of the shareholders.

iv) Partnerships are governed by the Partnerships Act, while c o m p e s are governed by the Companies Act, 1956.

Let us understand the different types of Companies.

3.5.2 Private Limited Company

In a private limited company, the business is held and owned by shareholders, who must not be less than two in number. It acquires a legal entity which takes **formal** shape when it is set up in the Memorandum of Association and Articles of Association, a legal requirement. It has a limited liability. Shares in the company can be bought and sold but not to the general public. The company cannot seek a quotation on the stock exchange. Even though there is limited liability, there are limits to the conduct and behaviour of the directors, who have to take responsibility.

3.53 Public Limited Company

A public limited company must not be confused with a public sector company which means a company owned by the government. A public limited company basically means a company which is in the private sector, but the shares of which are open to the general public. In the case of a public limited company, members of the general public are free to buy and sell shares of the company. Hence the company can raise **finance** from numerous and diverse sources. Some companies, through the strength of their size are able to justify and get a stock exchange listing. This further increases their ability to raise capital.

What are the advantages of a public limited company? Its shareholders have limited liabiity. There is long term continuity and ease of ownership transfer. Moreover, the company can utilize specialised management skills and large capital resources. However, the public **limited** company has certain disadvantages:

- Such companies are difficult and expensive to set up.
- There may be some inflexibility arising from problems of size, and this may lead to organisational problems.
- Motivational problems may arise from a separation of ownership and control.
- Ownership rests with numerous shareholders while control in functioning is exercised by paid managers who take decisions.

An important type of company is the multinational company, which **as** the name suggests, operates in several **countries** although it may be based in one country. In **case** of tourism, international hotel chains are a prime example of multinational companies.

3.5.4 The' Franchise

This is yet another form of business which exists in the tourism sector. The franchise is characterised by an agreement, called a franchising agreement, between two parties, a franchiser and franchisee. Under a franchising agreement, the franchisee agrees to pay the franchiser a royalty or commission apart from a flat fee, in exchange for the use of a national or international brand name and, where appropriate, other help such **as** building plants and site selection, as well as sometimes production methods, management and accounting procedures. Establishing and running the business while buying into a franchise involves high cost, but risks are **considerably** reduced. Franchising is quite prevalent in the restaurant business and food industry.

3.6 OTHER FORMS OF ORGANISATIONS

Certain other forms of **organisations** are also there in tourism :

1) Tourism Departments : The Government of India and various State Governments have tourism departments. These are non- profit making organisations involved in tourism policy formation, planning and promotion. (see TS-1 Unit 5)

2) **Tourism Development Corporations** : There are commercial profit earning organisations like the ITDC of the Central Government or of State Governments like M P Tourism Development Corporation or **Rajasthan** Tourism Development Corporation etc. They run hotels, other accommodation units, conducted tours, guide services etc. on commercial basis (see TS-1 Unit 5).

3) **Local Bodies :** In some cases, the local body like a municipality own leisure or sports complexes which are also used by tourists. Besides tourist attractions are **being** built by the local bodies as joint ventures with commercial enterprises.

4) **Cooperatives**: Cooperative Societies are enterprises owned and **run** by the members who form it. For example, **craftmen** may **form** a Cooperative to market their products to tourists or those providing paying guest accommodation may form a Cooperative to market or run their accommodation.

Check Your Progress - 3

1) What disadvantages does a public limited company have?

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2) Differentiate between a partnership and a joint stock company.

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3.7 LET US SUM UP

The tourism industry primarily supplies services in the market for tourism products. We have seen that those goods and services which are bought and sold in the market are called commodities.

The market for tourism, like most markets is characterised by the existence of several business forms: sole proprietorship, partnership and joint stock company. All these forms have their own advantages and disadvantages. In case you intend to start your own enterprise you can keep these in view and decide whether you want to go for sole proprietorship or partnership and so on depending on your resources and capabilities. Besides, a knowledge of corporate forms is also useful for dealing with or working in **organisations**.

3.7 KEYWORDS

Corporation: **An incorporated** company. Generally, any company

Dividend: the **part** of the profit which is not retained by the company and is distributed among the shareholders.

Exchange: an abstract term denoting the buying and selling of goods and services at their prices

Share Capital: it is one of a number of equal portions in the money capital of a company, which entitles the owner to a portion of the distributed profits.

Stock Exchange: it is a market where the shares, also called stocks of a company are brought and sold. A stock exchange is known as a secondary market because the orginal owner of the shares of a company sells it to the new owners.

Turnover: the value of total sales revenue earned by a business firm over a time period

3.8 ANSWERS TO CHECK YOUR PROGRESS EXERCISES

Check Your Progress - 1

1) Single ownership, Common identity, Unlimited liability, Profits do not have to be shared. See Sub-sec. **3.3.1**

2) Easy to set up and dissolve, Independence and **flexibility** in decision making, Incentive towards effort because sole proprietor gets to keep the profits, Proprietor can respond quickly to changed market conditions, etc. See Sub-sec. **3.3.2.**

3) Financial capital limited to owner's money and borrowings, Managerial skills may be inadequate, etc. See Sub-sec. **3.3.3.**

Check Your Progress - 2

1) Base your answer on Sub-sec. **3.4.1**

2) Read Sub-sec. **3.4.2** for your answer.

Check Your Progress-3

1) See Sub-sec. **3.5.3** for your answer.

2) A partnership has no legal entity of its own whereas a company is incorporated and hence has an independent legal entity; A company has limited liability while partnership has unlimited liability; Share of partner in the business is not transferable without the consent of all co-partners, whereas company shares are **freely** transferable; Partnerships are governed by Partnership Act while companies are governed by the Companies Act.