

PROFESSIONAL ETHICS IN BUSINESS

LECTURE FOUR

..... **Business Organisation - Introduction**

Meaning

Business: Business means the state of being busy, in other words those activities which involve production of wealth. A business is an enterprise which means distributes or provides an article or services which other members of the community need and are able and willing to pay for it.

Business organisation refers to all necessary arrangements required to conduct a business. It refers to all those steps that need to be undertaken for establishing relationship between men, material, and machinery to carry on business efficiently for earning profits. This may be called the process of organizing. The arrangement which follows this process of organizing is called a business undertaking or organisation. A business undertaking can be better understood by analyzing its characteristics.

Characteristics

1. **Distinct Ownership:** The term ownership refers to the right of an individual or a group of individuals to acquire legal title to assets or properties for the purpose of running the business. A business firm may be owned by one individual or a group of individuals jointly.
2. **Lawful Business:** Every business enterprise must undertake such business which is lawful, that is, the business must not involve activities which are illegal.
3. **Separate Status and Management:** Every business undertaking is an independent entity. It has its own assets and liabilities. It has its own way of functioning. The profits earned or losses incurred by one firm cannot be accounted for by any other firm.
4. **Dealing in goods and services:** Every business undertaking is engaged in the production and/or distribution of goods or services in exchange of money.
5. **Continuity of business operations:** All business enterprise engage in operation on a continuous basis. Any unit having just one single operation or transaction is not a business unit.
6. **Risk involvement:** Business undertakings are always exposed to risk and uncertainty. Business is influenced by future conditions which are unpredictable and uncertain. This makes business decisions risky, thereby increasing the chances of loss arising out of business.

Forms of Business

The most important forms of business organisation are as follows:

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- A. Sole Proprietorship
- B. Partnership
- C. Joint Stock Company
- D. Private Limited Company
- E. Co-operative Society

A. Sole proprietorship

A sole proprietorship is the oldest and the most common form of business. It is a one-man organisation where a single individual owns, manages and controls the business.

Characteristics:

1. **Ownership:** The business enterprise is owned by one single individual that is the individual has got legal title to the assets and properties of the business. The entire profit arising out of business goes to the sole proprietor. Similarly, he also bears the entire risk or loss of the firm.
2. **Management:** The owner of the enterprise is generally the manager of the business. He has got absolute right to plan for the business and execute them without any interference from anywhere. He is the sole decision maker.
3. **Source of Capital:** The entire capital of the business is provided by the owner. In addition to his own capital he may raise more funds from outside through borrowings from close relatives or friends, and through loans from banks or other financial institutions.
4. **Legal Status:** The proprietor and the business enterprise are one and the same in the eyes of law. There is no difference between the business assets and the private assets of the sole proprietor. The business ceases to exist in the absence of the owner.
5. **Liability:** The liability of the sole proprietor is unlimited. This means that, in case the sole proprietor fails to pay for the business obligations and debts arising out of business activities, his personal property can be used to meet those liabilities.
6. **Stability:** The stability and continuity of the firm depend upon the capacity, competence and the life span of the proprietor.
7. **Legal Formalities:** In the setting up, functioning and dissolution of a sole proprietorship business no legal formalities are necessary. However, a few legal restrictions may be there in setting up a particular type of business. For example, to open a restaurant, the sole proprietor needs a license from the local municipality; to open a chemist shop, the individual must have a license from the government.

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Advantages of Sole Proprietorship:

1. **Easy Formation:** The biggest advantage of a sole tradership business is its easy formation. Anybody wishing to start such a business can do so in many cases without any legal formalities.
2. **Better Control:** The owner has full control over his business. He plans, organises, co-ordinates the various activities. Since he has all authority, there is always effective control.
3. **Prompt Decision Making:** As the sole trader takes all the decisions himself the decision making becomes quick, which enables the owner to take care of available opportunities immediately and provide immediate solutions to problems.
4. **Flexibility in Operations:** One man ownership and control makes it possible for change in operations to be brought about as and when necessary.
5. **Retention of Business Secrets:** Another important advantage of a sole proprietorship business is that the owner is in a position to maintain absolute secrecy regarding his business activities.
6. **Direct Motivation:** The owner is directly motivated to put his best efforts as he alone is the beneficiary of the profits earned.
7. **Personal Attention to Consumer Needs:** In a sole tradership business, one generally finds the proprietor taking personal care of consumer needs as he normally functions within a small geographical area.
8. **Creation of Employment:** A sole tradership business facilitates self-employment and also employment for many others. It promotes entrepreneurial skill among the individuals.
9. **Social Benefits:** A sole proprietor is the master of his own business. He has absolute freedom in taking decisions, using his skill and capability. This gives him high self-esteem and dignity in the society and gradually he acquires several social virtues like self- reliance, self-determination, independent thought and action, initiative, hard work etc.,. Thus, he sets an example for others to follow.
10. **Equitable Distribution of Wealth:** A sole proprietorship business is generally a small scale business. Hence there is opportunity for many individuals to own and manage small business units. This enables widespread dispersion of economic wealth and diffuses concentration of business in the hands of a few.

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Disadvantages of Sole Proprietorship:

1. **Unlimited Liability:** In sole proprietorship, the liability of business is recovered from the personal assets of the owner. It restricts the sole trader to take more risk and increases the volume of his business.
2. **Limited Financial Resources:** The ability to raise and borrow money by one individual is always limited. The inadequacy of finance is a major handicap for the growth of sole proprietorship.
3. **Limited Capacity of Individual:** An individual has limited knowledge and skill. Thus his capacities to undertake responsibilities, his capacity to manage, to take decisions and to bear the risks of business are also limited.
4. **Uncertainty of duration:** The existence of a sole tradership business is linked with the life of the proprietor. Illness, death or insolvency of the owner brings an end to the business. The continuity of business operation is, therefore, uncertain.

Suitability of Sole Proprietorship Form

From the discussion of the advantages and disadvantages of sole proprietorship above, it is clear that this form of business organization is most suited where:

1. The amount of capital is small
2. The nature of business is simple in character requiring quick decisions to be taken
3. Direct contact with the customer is essential and
4. The size of demand is not very large.

These types of conditions are satisfied by various types of small business such as retail shops, legal or medical or accounting profession, tailoring, service like dry cleaning or vehicle repair etc. hence sole proprietor form of organization is mostly suitable for these lines of businesses. This form of organization also suits those individuals who have a strong drive for independent thinking and highly venturesome in their attitude.

B. Partnership

Meaning

A partnership form of organisation is one where two or more persons are associated to run a business with a view to earn profit. Persons from similar background or persons of different ability and skills, may join together to carry on a business. Each member of such a group is individually known as '**partner**' and collectively the members are known as a '**partnership firm**'. These firms are governed by the Indian Partnership Act, 1932.

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Characteristics:

1. **Number of Partners:** A minimum of two persons are required to start a partnership business. The maximum membership limit is 10 in case of banking business and 20 in case of all other types of business.

2. **Contractual Relationship:** The relation between the partners of a partnership firm is created by contract. The partners enter into partnership through an agreement which may be verbal, written or implied. If the agreement is in writing it is known as a '**Partnership Deed**'.

3. **Competence of Partners:** Since individuals have to enter into a contract to become partners, they must be competent enough to do so. Thus, minors, lunatics and insolvent persons are not eligible to become partners.

However, a minor can be admitted to the benefits of partnership i.e. he can have a share in the profits.

4. **Sharing of Profit and Loss:** The partners can share profit in any ratio as agreed. In the absence of an agreement, they share it equally.

5. **Unlimited Liability:** The partners are liable jointly and severally for the debts and obligations of the firm. Creditors can lay claim on the personal properties of any individual partner or all the partners jointly. The liability of a minor is, however, limited to the extent of his share in the profits, in case of dissolution of a firm.

6. **Principal-Agent Relationship:** The business in a partnership firm may be carried on by all the partners or any one of them acting for all. This means that every partner is an agent when he is acting on behalf of others and he is a principal when others act on his behalf. It is, therefore, essential that there should be mutual trust and faith among the partners in the interest of the firm.

7. **Transfer of Interest:** No partner can sell or transfer his interest in the firm to anyone without the consent of other partners.

8. **Legal Status:** A partnership firm is just a name for the business as a whole. **The firm means partners and the partners mean the firm.** Law does not recognise the firm as a separate entity distinct from the partners.

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9. **Voluntary Registration:** Registration of partnership is not compulsory. But since registration entitles the firm to several benefits, it is considered desirable. For example, if it is registered, any partner can file a case against other partners, or a firm can file a suit against outsiders in case of disputes, claims, disagreements, etc.

10. **Dissolution of Partnership:** Dissolution of partnership implies not only a complete closure or termination of partnership business, but it also includes any change in the existing agreement among the partners due to a change in the number of partners.

Advantages of Partnership Firm:

1. **Easy Formation:** A partnership can be formed without many legal formality and expenses. Every partnership firm need not be registered.

2. **Larger Resources:** As compared to sole proprietorship, a partnership firm can pool larger financial resources. Thus it can enter into bigger operations and can have more credit facilities. It can also have better managerial talent.

3. **Flexibility in operation:** Flexibility is due to a limited number of partners. These partners can change their operations and amend objectives if necessary by mutual consent.

4. **Better Management:** Partners take more interest in the affairs of business as there is a direct relationship between ownership, control and profit. They often meet to discuss the affairs of business and can take prompt decision.

5. **Sharing of Risk:** In partnership, risk of loss is easier to bear by individual partners as it is shared by all the partners.

6. **Protection of minority interest:** Every partner has an equal say in decision making. A partner can prevent a decision being taken if it adversely affects his interests. In extreme cases a dissenting partner may withdraw from partnership and can dissolve it.

7. **Better Public Relations:** In a partnership firm the group managing the affairs of the firm is generally small. It facilitates cordial relationship with the public.

Disadvantages of partnership Firm:

1. **Instability:** A partnership firm does not continue to exist indefinitely. The death, insolvency or lunacy of a partner may bring about an unexpected end to partnership.

2. **Unlimited Liability:** As the liability of partners is joint and several to an unlimited extent, any one of the partners can be called upon to pay all the debts even from his personal properties.

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Further, as every partner has a right to take part in the management of the firm, any wrong decision by a single partner may lead to heavy liabilities for others.

3. **Lack of Harmony:** Since every partner has equal right, there are greater possibilities of friction and quarrel among the partners. Differences of opinion may lead to mistrust and disharmony which may ultimately result in disruption and closure of the firm.

4. **Limited Capital:** As there is a restriction on the maximum number of partners, the capital which can be raised is limited.

Suitability of Partnership Firm:

In a partnership firm, persons from different walk of life having ability, managerial talent and skill join together to carry on a business. This increases the administrative strength of the organisation, the financial resources, the skill and expertise, and reduces risk. Such firms are most suitable for comparatively small business such as retail and wholesale trade, professional services, medium sized mercantile houses and small manufacturing units. Generally it is seen that many organizations are initially started as partnership firms and later, when it is economically viable and financially attractive for the investors, it is converted into a company.

C. Joint Stock Company/ Public Limited Company:

A public limited company is a voluntary association of members which is incorporated and, therefore has a separate legal existence and the liability of whose members is limited.

Characteristics:

1. **Artificial Person:** A Joint Stock Company is an artificial person in the sense that it is created by law and does not possess physical attributes of a natural person. However, it has a legal status.

2. **Separate Legal Entity:** Being an artificial person, a company has an existence independent of its members. It can own property, enter into contract and conduct any lawful business in its own name. It can sue and can be sued in the court of law. A shareholder cannot be held responsible for the acts of the company.

3. **Common Seal:** Every company has a common seal by which it is represented while dealing with outsiders. Any document with the common seal and duly signed by an officer of the company is binding on the company.

4. **Perpetual Existence:** A company once formed continues to exist as long as it fulfils the requirements of law. It is not affected by the death, lunacy, insolvency or retirement of any of its members.

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5. **Limited Liability:** The liability of a member of a Joint Stock Company is limited by guarantee or the shares he owns. In other words, in case of payment of debts by the company, a shareholder is held liable only to the extent of his share.
6. **Transferability of Shares:** The members of a company are free to transfer the shares held by them to anyone else.
7. **Formation:** A company comes into existence only when it has been registered after completing the formalities prescribed under the Indian Companies Act 1956. A company is formed by the initiative of a group of persons known as **promoters**
8. **Membership:** A company having a minimum membership of **two** persons and maximum **fifty** is known as a **Private Limited Company**. But in case of a Public Limited Company, the minimum is **seven** and the maximum membership is **unlimited**.
9. **Management:** Joint Stock Companies have democratic management and control. Even though the shareholders are the owners of the company, all of them cannot participate in the management process. The company is managed by the elected representatives of shareholders known as **Directors**.
10. **Capital:** A Joint Stock Company generally raises a large amount of capital through issue of shares.

Advantages of Joint Stock Company:

1. **Limited Liability:** In a Joint Stock Company the liability of its members is limited to the extent of shares held by them. This attracts a large number of small investors to invest in the company. It helps the company to raise huge capital. Because of limited liability, a company is also able to take larger risks.
2. **Continuity of existence:** A company is an artificial person created by law and possesses independent legal status. It is not affected by the death, insolvency etc. of its members. Thus it has a **perpetual existence**.
3. **Benefits of large scale operation:** It is only the company form of organisation which can provide capital for large scale operations. It results in large scale production consequently leading to increase in efficiency and reduction in the cost of operation. It further opens the scope for expansion.
4. **Professional Management:** Companies, because of complex nature of activities and operations and large volume of business, require professional managers at every level of organisation. And because of their financial strength they can afford to appoint such managers. This leads to efficiency.

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5. **Social Benefit:** A joint stock company offers employment to a large number of people. It facilitates promotion of various ancillary industries, trade and auxiliaries to trade. Sometimes it also donates money for education, health, community service and renders help to charitable and social institutions.

6. **Research and Development:** A company generally invests a lot of money on research and development for improved processes of production, designing and innovating new products, improving quality of product, new ways of training its staff, etc.

Disadvantages of Joint Stock Company:

1. **Formation is not easy:** The formation of a company involves compliance with a number of legal formalities under the companies Act and compliance with several other Laws.

2. **Control by a Group:** Companies are controlled by a group of persons known as the **Board of Directors**. This may be due to lack of interest on the part of the shareholders who are widely dispersed; ignorance, indifference and lack of proper and timely information. Thus, the democratic virtues of a company do not really exist in practice.

3. **Speculation and Manipulation:** The shares of a company are purchased and sold on the stock exchanges. The value or price of a share is determined in terms of the dividend expected and the reputation of the company. These can be manipulated. Besides, there is excessive speculation which is regarded as a social evil.

4. **Excessive government control:** A company is expected to comply with the provisions of several Acts. Non-compliance of these invites heavy penalty. This affects the smooth functioning of the companies.

5. **Delay in Policy Decisions:** A company has to fulfill certain procedural formalities before making a policy decision. These formalities are time consuming and, therefore, policy decisions may be delayed.

6. **Social abuses:** A joint stock company is a large scale business organisation having huge resources. This provides a lot of power to them. Any misuse of such power creates unhealthy conditions in the society e.g. having monopoly of a particular business, industry or product; influencing politicians and government in getting their work done; exploiting workers, consumers and investors.

Suitability of Joint Stock Company:

A joint stock company is suitable where the volume of business is quite large, the area of operation is widespread, the risk involved is heavy and there is a need for huge financial resources and manpower. It is also preferred when there is need for professional management and flexibility of

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operations. In certain businesses like banking and insurance, business can only be undertaken by joint stock companies.

D. Private Limited Company:

A private limited company is a voluntary association of not less than two and not more than fifty members, whose liability is limited, the transfer of whose shares is limited to its members and who is not allowed to invite the general public to subscribe to its shares or debentures.

A private company is preferred by those who wish to take the advantage of limited liability but at the same time desire to keep control over the business within a limited circle and maintain the privacy of their business.

Advantages

- **Limited Liability:** It means that if the company experience financial distress because of normal business activity, the personal assets of shareholders will not be at risk of being seized by creditors.
- **Continuity of existence:** business not affected by the status of the owner.
- **Minimum number of shareholders** need to start the business are only 2.
- **More capital** can be raised as the maximum number of shareholders allowed is 50.
- **Scope of expansion** is higher because easy to raise capital from financial institutions and the advantage of limited liability

Disadvantages

- The shares in a private limited company cannot be sold or transferred to anyone else without the agreement of other shareholders (not freely transferable)
- Not allowed to invite public to subscribe to its shares
- Scope for promotional frauds
- Undemocratic control

Difference between Sole Proprietorship and Partnership firm:

Basis	Sole Proprietorship	Partnership
1. Membership	Only one member	Minimum membership is two, maximum membership is ten incase of banking business twenty
2. Functioning	A sole trader manages his business at his	May be managed by all partners or

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	free will.	any one on behalf of all others.
3. Formation	Easy and can be formed at any time the owner decides.	An agreement is required between the partners to start a business.
4. Secrecy	Business secrets are not open to anyone other than the proprietor	Business secrets are open to every partner.
5. Finance	Scope for raising capital is limited	Scope for raising capital is relatively more.
6. Continuity of business	Comes to an end with the death of the sole trader.	The business of a firm does not come to an end if a partner leaves the firm.
7. Decision Making	Owner alone takes decision and so it is quick.	All partners must agree to important decisions and so decision making may take time.
8. Liability	Unlimited and burden is heavy	Unlimited but less burdensome as it is shared by partners.

Partnership and Joint Stock Company

Basis	Partnership	Joint Stock Company
1. Formation	It is easy to form as registration is not compulsory	It requires many legal formalities to be completed before the company comes into existence
2. Operation	Governed by the Partnership Act, 1932	Governed by the companies Act, 1956
3. Membership	Minimum is two, maximum is 10 in banking business and 20 in other business.	In case of Private Company minimum is 2, maximum is 50; in case of Public company minimum is 7 and maximum unlimited.
4. Legal Status	No separate legal entity	Separate legal entity from that of its members
5. Liability	Joint and several to an unlimited extent	Limited to the value of shares held for limited companies
6. Management	All or any one on behalf of all partners is are entitled	Only the Board of directors authorized

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7. Transfer of shares	Consent of all partners required	Shares are freely transferable
8. Existence	Dissolves with the death, retirement or insanity of a partner etc.	Perpetual existence, unaffected by death, retirement, insolvency of the shareholders
9. Finance	Relatively limited scope for raising finance	Vast and unlimited scope for raising finance

Distinction Between A Public Company And a Private Company Following are the main points of difference between a Public Company and a Private Company:

1. Minimum Paid-up Capital: A company to be Incorporated as a Private Company must have a minimum paid-up capital of Rs. 1,00,000, whereas a Public Company must have a minimum paid-up capital of Rs. 5,00,000.
2. Minimum number of members: Minimum number of members required to form a private company is 2, whereas a Public Company requires atleast 7 members.
3. Maximum number of members: Maximum number of members in a Private Company is restricted to 50, there is no restriction of maximum number of members in a Public Company.
4. Transferability of shares: There is complete restriction on the transferability of the shares of a Private Company through its Articles of Association, whereas there is no restriction on the transferability of the shares of a Public company.
5. Issue of Prospectus: A Private Company is prohibited from inviting the public for subscription of its shares, i.e. a Private Company cannot issue Prospectus, whereas a Public Company is free to invite public for subscription i.e., a Public Company can issue a Prospectus.
6. Number of Directors: A Private Company may have 2 directors to manage the affairs of the company, whereas a Public Company must have atleast 3 directors.
7. Consent of the directors: There is no need to give the consent by the directors of a Private Company, whereas the Directors of a Public Company must have file with the Registrar consent to act as Director of the company.
8. Qualification shares: The Directors of a Private Company need not sign an undertaking to acquire the qualification shares, whereas the Directors of a Public Company are required to sign an undertaking to acquire the qualification shares of the public Company.
9. Commencement of Business: A Private Company can commence its business immediately after its incorporation, whereas a Public Company cannot start its business until a Certificate to commencement of business is issued to it.

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10. Shares Warrants: A Private Company cannot issue Share Warrants against its fully paid shares, whereas a Public Company can issue Share Warrants against its fully paid up shares.

11. Further issue of shares: A Private Company need not offer the further issue of shares to its existing share holders, whereas a Public Company has to offer the further issue of shares to its existing share holders as right shares. Further issue of shares can only be offer to the general public with the approval of the existing share holders in the general meeting of the share holders only.

12. Statutory meeting: A Private Company has no obligation to call the Statutory Meeting of the member, whereas of Public Company must call its statutory Meeting and file Statutory Report with the Register of Companies.

13. Quorum: The quorum in the case of a Private Company is TWO members present personally, whereas in the case of a Public Company FIVE members must be present personally to constitute quorum. However, the Articles of Association may provide and number of members more than the required under the Act.

14. Managerial remuneration: Total managerial remuneration in the case of a Public Company cannot exceed 11% of the net profits, and in case of inadequate profits a maximum of Rs. 87,500 can be paid, whereas these restrictions do not apply on a Private Company.

15. Special privileges: A Private Company enjoys some special privileges, which are not available to a Public Company

E. **Co-Operatives:**

A co-operative society is a voluntary association started with the aim of service of its members. It is a form of business where individuals belonging to the same class join their hands for the promotion of their common goals. These are generally formed by the poor people or weaker section people in the society. It reflects the desire of the poor people to stand on their own legs or own merit. The philosophy of the formation of co-operative society is “all for each and each for all”. It is voluntary association of persons for mutual benefit and its aims are accomplished through self help and collective effort.

Advantages:

1. Easy Formation:

Any ten adult persons can voluntarily form themselves into an association and get it registered with the Registrar of Co-operatives. Formation of a cooperative society also does not involve long and complicated legal formalities.

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2. Limited Liability:

Like company form of ownership, the liability of members is limited to the extent of their capital in the cooperative societies.

3. Perpetual Existence:

A cooperative society has a separate legal entity. Hence, the death, insolvency, retirement, lunacy, etc., of the members do not affect the perpetual existence of a cooperative society.

4. Social Service:

The basic philosophy of cooperatives is self-help and mutual help. Thus, cooperatives foster fellow feeling among their members and inculcate moral values in them for a better living.

5. Open Membership:

The membership of cooperative societies is open to all irrespective of caste, colour, creed and economic status. There is no limit on maximum members.

6. Tax Advantage:

A cooperative society is exempted from income-tax and surcharge on its earnings up to a certain limit. Besides, it is also exempted from stamp duty and registration fee.

7. State Assistance:

Government has adopted cooperatives as an effective instrument of socio-economic change. Hence, the Government offers a number of grants, loans and financial assistance to the cooperative societies – to make their working more effective.

8. Democratic Management:

The management of cooperative society is entrusted to the managing committee duly elected by the members on the basis of 'one-member one -vote' irrespective of the number of shares held by them. The proxy is not allowed in cooperative societies. Thus, the management in cooperatives is democratic.

Disadvantages:

In spite of its numerous advantages, the cooperative also has some disadvantages which must be seriously considered before opting for this form of business ownership. The important among the disadvantages are:

1. Lack of Secrecy:

A cooperative society has to submit its annual reports and accounts with the Registrar of Cooperative Societies. Hence, it becomes quite difficult for it to maintain secrecy of its business affairs.

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2. Lack of Business Acumen:

The member of cooperative societies generally lack business acumen. When such members become the members of the Board of Directors, the affairs of the society are expectedly not conducted efficiently. These also cannot employ the professional managers because it is neither compatible with their avowed ends nor the limited resources allow for the same.

3. Lack of Interest:

The paid office-bearers of cooperative societies do not take interest in the functioning of societies due to the absence of profit motive. Business success requires sustained efforts over a period of time which, however, does not exist in many cooperatives. As a result, the cooperatives become inactive and come to a grinding halt.

4. Corruption:

In a way, lack of profit motive breeds fraud and corruption in management. This is reflected in misappropriations of funds by the officials for their personal gains.

5. Lack of Mutual Interest:

The success of a cooperative society depends upon its members' utmost trust to each other. However, all members are not found imbued with a spirit of co-operation. Absence of such spirit breeds mutual rivalries among the members. Influential members tend to dominate in the society's affairs.

PERFORMANCE APPRAISAL:

Performance appraisal is a method of evaluating the behaviour of employees in the work spot, normally including both the quantitative and qualitative aspects of job performance. Performance appraisal or merit rating rates the man and not the job as it concerned with assessing the abilities of an individual. Performance appraisal is the systematic description of an employee's job-relevant strength and weaknesses.

“It is the process of evaluating the performance and qualification of the employees in terms of the requirement of the job for which he is employed, for purposes of administration including placement, selection of promises, providing financial rewards and other actions which require differential treatment among the members of a group as distinguished from actions affecting all members equally”. - HEYEL

The basic purpose is to find out how well the employee is performing the job and establish a plan of improvement. It is a continuous process and is arranged periodically according to a definite plan. It to how well someone is doing the assigned job.

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NEED FOR PERFORMANCE APPRAISAL:

1. To decide on salary fixation, confirmation, promotion. Transfer and demotions.
2. To counsel subordinates
3. Diagnose deficiency in the employee regarding skill, knowledge, determine training and development needs.
4. To prevent grievances and in disciplinary action.

OBJECTIVES OF PERFORMANCE APPRAISAL:

1. To create and maintain a satisfactory level of performance.
2. To contribute to the employee and development through training, self and management development programmes.
3. To help superiors to have a proper understanding about their subordinates.
4. To guide the job changes with the help to continuous ranking.
5. To facilitate fair and equitable compensation based on performance.
6. To decide on layoff, retrenchment etc.

PITFALL / PROBLEMS OF PERFORMANCE APPRAISAL:

Rating biases- problems with subjective measures.

- a. **Halo Effect** Tendency of the raters to depend excessively on the rating of one trait or behavioral consideration.
- b. **Error of central Tendency-[play safe policy]** Rating all the employees around the middle point of the rating scale.
- c. **The leniency and strictness-** The leniency bias crops when some raters have or tendency to be liberal in their rating by assigning higher rates.
- d. **Strictness- Assigning consistently low rates.**
- e. **Personal prejudice-** Dislike any employee or any group may distort the rating purpose.
- f. **The Recency Effect-** The rates generally remembers the recent action of the employee at the time of rating and rate them on the basis of these recent actions, rather than on the whole activities.

Methods of Performance Appraisal:

- (i) **Trait Based techniques:** It means performance evaluated by qualities it can be as such as
Job knowledge – having sufficient knowledge in job
Leadership – having or acquired leadership qualities
Loyalty - faithfulness

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(ii) **Graphical scale method:** under this method traits are broadly classified and put in a graphical form. The graphic rating scale is one of the most popular and simplest techniques for appraising performance. It is also known as linear rating scale. In this method, the printed appraisal form is used to appraise each employee.

The form lists traits (such as quality and reliability) and a range of job performance characteristics (from unsatisfactory to outstanding) for each trait. The rating is done on the basis of points on the continuum. The common practice is to follow five points scale.

The rater rates each appraisee by checking the score that best describes his or her performance for each trait all assigned values for the traits are then totaled. Figure 28-3 shows a typical graphic rating scale.

Fig. 28.3: Sample of Graphic Rating Scale Items and Format

Performance Factor	Performance Rating				
<i>Quality of work is the accuracy, skill, and completeness of work.</i>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Consistently unsatisfactory	Occasionally unsatisfactory	Consistently satisfactory	Sometimes superior	Consistently superior
<i>Quantity of work is the volume of work done in a normal workday.</i>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Consistently unsatisfactory	Consistently unsatisfactory	Consistently satisfactory	Sometimes superior	Consistently superior
<i>Job knowledge is information pertinent to the job that an individual should have for satisfactory job performance.</i>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Poorly informed about work duties	Occasionally unsatisfactory	Can answer most questions about the job	Understands all phases of the job	Has complete mastery of all phases of the job
<i>Dependability in following directions and company policies without supervision.</i>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
	Required constant supervision	Requires occasional follow-up	Usually can be counted on	Requires very little supervision	Requires absolute minimum of supervision

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This method is good for measuring various job behaviours of an employee. However, it is also subjected to rater's bias while rating employee's behaviour at job. Occurrence of ambiguity in design- mg the graphic scale results in bias in appraising employee's performance.

(iii) **Ranking method:** this method is very easy here rank is provided on the basis of certain traits, ranking can be outstanding, good and below average. It is the oldest and simplest formal systematic method of performance appraisal in which employee is compared with all others for the purpose of placing order of worth. The employees are ranked from the highest to the lowest or from the best to the worst. In doing this the employee who is the highest on the characteristic being measured and also the one who is L lowest, are indicated. Then, the next highest and the next lowest between next highest and lowest until all the employees to be rated have been ranked. Thus, if there are ten employees to be appraised, there will be ten ranks from 1 to 10.

Limitations:

- It does not tell that how much better or worse one is than another,
- The task of ranking individuals is difficult when a large number of employees are rated, and
- It is very difficult to compare one individual with others having varying behavioural traits.

To remedy these defects, the paired comparison method of performance appraisal has been evolved.

(iv) **Grading:** here categories such as good, very good and excellent are used. In this method, certain categories of worth are established in advance and carefully defined. There can be three categories established for employees: outstanding, satisfactory and unsatisfactory. There can be more than three grades. Employee performance is compared with grade definitions. The employee is, then, allocated to the grade that best describes his or her performance.

(v) **Group appraisal:** Here a small number of persons are taken and appraisal is done.

(vi) **MBO (Management By Objectives):** Under this method the superiors and subordinate managers of an organization come and discuss upon the employee whether to promote or not etc.

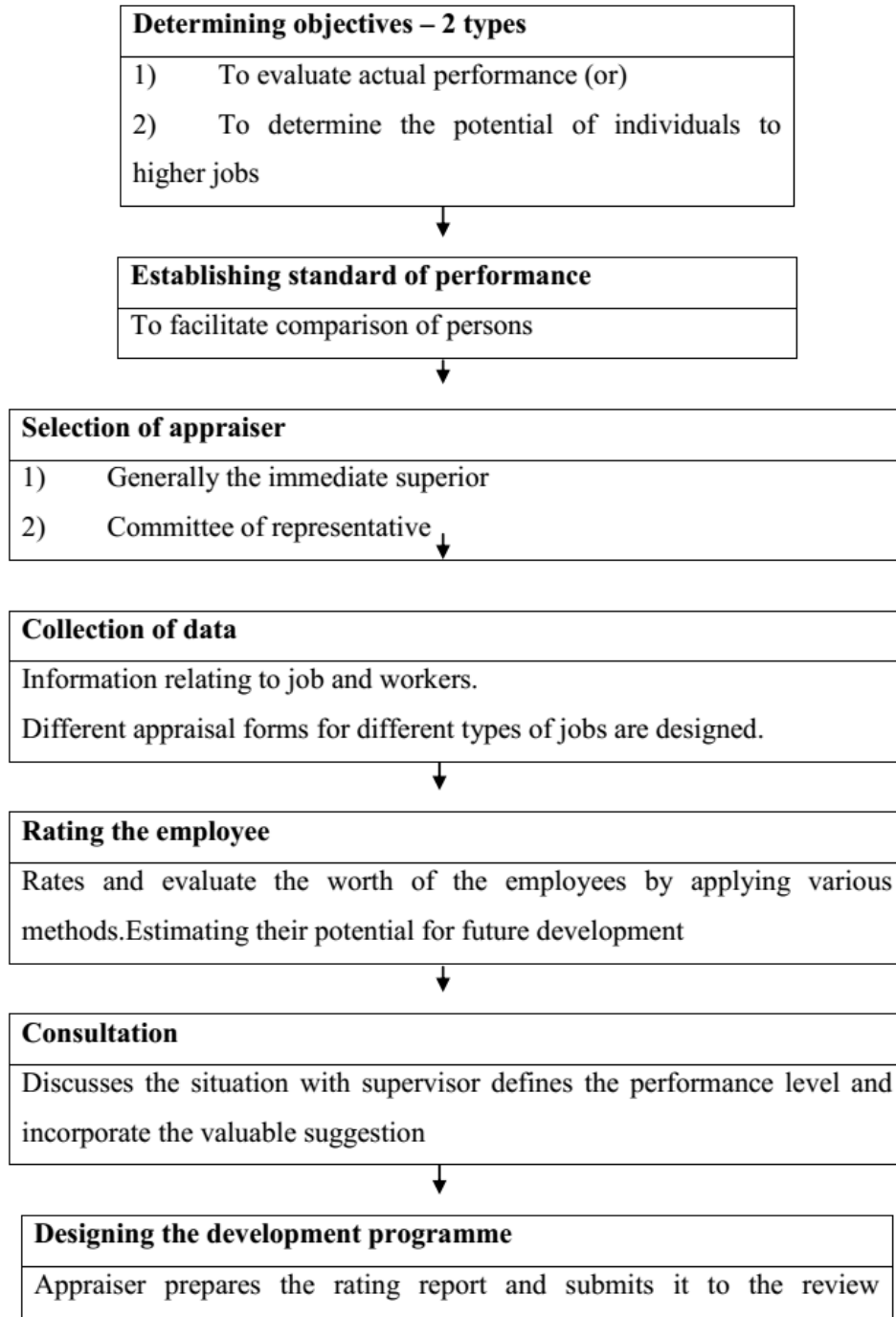
(vii) **360 degree appraisal:** Under 360 – degree appraisal, performance information such as employee's skills, abilities and behaviours, is collected "all around" an employee, i.e., from his/her supervisors, subordinates, peers and even customers and clients.

In other worlds, in 360-degree feedback appraisal system, an employee is appraised by his supervisor, subordinates, peers, and customers with whom he interacts in the course of his job performance. All these appraisers provide information or feedback on an employee by completing survey questionnaires designed for this purpose.

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All information so gathered is then compiled through the computerized system to prepare individualized reports. These reports are presented to the employees being rated. They then meet the appraiser—be it one's superior, subordinates or peers—and share the information they feel as pertinent and useful for developing a self-improvement plan.

Performance appraisal reporting or steps in effective performance appraisal:



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committee and inturn it is submitted to top management / executives who designs the various development programmes.



Follow up

Yearly or half yearly follow up measures