# SUBJECT— BUSINESS ORGANISATION

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**BY::**

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# FORMS OF BUSINESS ORGANISATION

**Business organization can be categorized into several forms depending upon various parameters which will be discussed in this lecture…**

## 1 INTRODUCTION

In the previous class you learnt that any activity camed with profit motive is called business and that such activity may be an industrial activity, a trading activity or a service activity like banking, insurance, transportation, etc. You have also learnt that bringing various resources together to set up a business and putting them to work systematically is termed as business organisation. The person who takes initiative to set up a business, provides the necessary funds and bears the risk involved is called the owner of the business.

TYPES OF BUSINESS ORGANISATION

## 2 SOLE TRADER ORGANISATION

The sole trader organisation (also called proprietorship) is the oldest form of organization and the most common form of organisation for small business even today. It is the simplest and easiest to form. What is required is that an individual decides about the type of business to be started and arranges the necessary capitaI. Required capital may be mobilised from his own savings, or may be borrowed from friends and relatives.

## Main Features

Based on the above discussion, we canlist the main features of sole trader organisation as :

**1 One man ownership:** The ownership lies with one person only. There are no associates l or partners. He invests his own money or borrows from the friends and relatives.

**2 No separation of ownership and management:** The owner himself manages the business. Therefore, the separation of ownership and management which is quite common in big business is not present in this form of organisation.

Since the proprietor himself manages the business, he exercises a high degree of supervision and control in the working of his business.

**3 No separate entity:** The business dpes not have an entity separate from the owner. The proprietor and the business entkrprise are one and the same.

4 All profits **t'o** proprietor: Since there are no partners, all the profits are enjoyed by the sole proprietor.

**5** Individual risk: All losses in the business are borne by the proprietor himself.

6 Unlimited liability: The proprietor has an unlimitedliability. This means that in case of loss even the personal propeity of the owner can be utilised for clearing the business obligations and debts,

7 **Less** legal.formalities: To set up sole proprietorship, no legal formalities are required. Of course, there are some legal restrictions for the setting up of a particular type of business.

**Merits and Limitations**

# Merits

**1** Easy formation: There are no legal formalities to be observed while starting this form of organisation. Therefore, its formation is very easy and simple. The expenditure involved in the process of formation is also negligible.

**2** Direct motivation: As you know, all the profits and gains of the business are solely and exclusively pocketed by The sole proprietor. This motivates the proprietor to work hard and develop the business to get more and more profits. His involvement in the business is, therefore, complete and free.

**3** Full control: The proprietor is the monarch of the business he owns. He manages thewhole business and takes all decisions himself. In other words, proprietor exercises fullcontrol over the functioning and working of the business.

4 Quick decision: The proprietor does no1 depend on others for decision making. Since there are no partners, he is not required to consult others. This enables the proprietor to take quick decisions on nunlerous matters concerning his business.

**5** Flexibility in operations: Being a small organisation it is easy to bring changes if situation so demands. In a large sized organisation to bring changes is difficult.

**6** Secrecy: Since the whole business is handled by the proprietor his business secrets are known to him only. He is not bound to publish his accounts. Therefore, the degree of secrecy is the highest in this form of organisation.
**7** Personal touch: When the proprietor handles everything relating to the business himself, it is easy to maintain a personal rapport with the customers. He can easily know their tastes, likes and dislikes and adjust his operations accordingly.
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# Limitations

**1** Limited resources: The capilal and other resources of an individual are always limited.The sole trader has to mainly rely on his own money and earnings, or he can borrow, if necessary, from relatives and friends. Thus, the proprietor has a limited capacity to raise funds. This makes it difficult to plan any large scale expansion.

2 Limited managerial capability: In the modern business, knowledge and skills in various fields like production, finance, marketing, etc., are required. It is not possible for a single individual to possess expertise in all these areas. So, his decisions may not be balanced.

**3** Not suitable for large scale operation: Sincathe resources of the sole trader are limited, it is suitable only for small business and not for large scale operations.

4 Unlimited liability: You know that the proprietor has an unlimited liability. In case of a loss, eveh his personal property and belongings can be utilised for clearing business obligations. Therefore, he cannot take much risk and is discouraged from expansion of his business.

5 Less stability: The continuity and stability of the business depends solely on one person. When the man dies, there is a likelihood of c1.osure of the business.

6 No check .and contrbl: As the sole trader is the monarch of.the business, no outsider can question him on his acts and deals. There are no checks **and** controls on the sole trader.

# PARTNERSHIP FORM OF ORGANISATION

You have learnt that the sole trader organisations have limited financial resources, iinlited managerial ability and skills, and unlimited liability. In case of expansion more capital and more managerial skills are required. At the same time, thc risk will also increase. A sole proprietor may not be able to fulfil all these requirements. A person who lacks, managerial skills may be having capital.

The persons who own the partnership business are individually called 'partners' and collectively known as the.'firm9 or 'partnership firm'. On an agreed basis, partners contribute to capital and share the responsibility of.running the business. However, in some cases one partner may provide the whole or major portion of the capital and others contribute techqical and managerial skills with or without some capital.

**Main Features**

From the above discussion, we can list the main features of partnership form of organization as follows :

1 PIurality of persons; To form a partnership firm, there should-be at least two persons.. The maximum limit on the number of persons is ten for banking business and twenty for other types of business.

**2 Contractual relationship:** Partnership is created by an agreement between persons called 'partners'. In other words, a person can become a partner only on thc basis of a contract. This contract could be oral, written or implied.

**3 Profit sharing:** There must be an agreement anlong the partners to share the profits and losses of the business of the partnership firm. This is onc of the basic elements of partnership. If two or more persons jointly own some property and share its income, it is not regarded as partnership.

**4 Existence of business:** The purpose of the agreement among the partners is to do some lawful business and share profits. If the purpose is something other than business, it should not be treated as partnership. For example, if the purpose is to carry some charitable work, it will not be treated as partnership.

**5 Principal-agent relationship:** The business of the firm may be carried on by all or one or more partners actlng for all the partners. Every partner is entitled to take part in the operations of the firm.

**6 Unlimited liability:** In respect of business debts, each partner has unlimited liability. This means that if the assets of the firms are not sufficient to meet the obligations of the firm, the partners have to pay from their private assets. The creditors can even realisc the whole of their dues from one of the partners

**7 Good faith and honesty: A** partnership agreement rests on good faith among the partners. The partners must be honest to each other and trust each other.

**8 Restriction on transfer of share:** A partner cannot transfer his share to an outsider without the consent of all the other partners.

**Partnership Deed**

You know that a partnership is formed by an agreement. Such agreement may be either written or oral. To avoid misunderstanding and unnecessary litigations,-it is always desirable to have a written agreement. When the written agreement is duly stalnped and registered, it is known as 'Partnership Deed'.
1 Name of the firm.
2 Naturd of the business to be carried out.
**3** aim of the partners.
4 The town at~dth e place where busifiess will be carried on.
*5,* The ampunt of capital to be c0ntributed.b~e ach partner.
*6* The profit and loss sharing ratio of each partner.
7 Loans and advances by partners and the interest payable on them.
8 The amount of drawings by each partner and the rate of interest allowed thereon.
9 The rate of interest on capital. ,
10 Duties, powers, and obligations of partners.

## Merits and Limitation

You have learnt about the main features of partnership. This would help you to identify the merits and limitations *of* this fonn of organisalion which are as follows.
**Merits**

**1 Easy formation:** Althongh the formation of a partnership firm is not as easy as rhc sole proprictorshipb, ut i t is much less difficult as compared to a company. Tile partness agreto do business together ancl draw up ancl sign the partncrslhip agreement. Al'ter that tliere are no complex goverlllnent laws ~.egulatingtl ic establislitnent of the partnership.

**2 More capital available:** Unlike sole propsictorship, there are two k)r more partners in partnership firms. So. ipartnersliio firm does not have to rely on a singlc individual as the source or its funcls. The added financial strength of the partners increases the borrowinig capacity of the firrn.

**3 More diverse-skills and expertise:** The partnership involves more people in decision making because there are Inorc owners. An icleal pnrtuersliip brings together partners who complement each other, not partners who have the same
.

**4 Flexibility:** Like $ole proprietorship, tlie parlnership busincsx IS ;ilso ownetl and run by the partners themselves.

**5 Secrecy: In** partnership firms, some secrecy can be maintaineel beca~lscth ere is no obligation to publish accounts of thc firrn.

**6 Keen interest:** Since parulers are 1i;tble to losses nnd risks oi';i l,usiness, they take keen interest in the aff'airs of' the business.

**8 Checks and controls over careless decisions:** Since the partnership is run on collcctive basis and all partners participate in major decisions. there is lesser scope for reckless and hasty decisions.

**9 Diffusion of risk:** The losses of the firm wi I1 be sliased by all the pilrtners. Hence, the share of loss in the case of each partner will bc less than that sustained in solc proprietorship.

## Limitations

**1 ' Limited capital:** Since there is a limit of' maximum partners (20 in non-banking firms and 10 in banking firms), the capital raising capacity of the partnership firms is lirnited as compared to a joint stock compriny.

**2 Unlimited liability:** The most important drawback of a partnership Sirm is that the liability of the partners is unlimited.

**3 No public confidence:** Since the accoullts are not published and publicised, the firm may not be able to command confidence of the public.

4 Non-transferability **of** interest: No partnet can transfer his interest in a firm without the **Business Organisation** consent of other partners. /'

5 Uncertainty: The sudden death, lunacy or insolvency of a partner leads to the dissolution of partnership. This breeds uncertainty in the continuity of a partnership firm. However, , this could be partly avoided if such matters are specified in the partnership agreement.

6 Conflicts among partners: There is scope for misunderstanding and conflicts among the partners. This may cause delays in decision making and may lead even to dissolution of the firm. To some extent, this problem could be avoided if the partnership agreement is clear and detailed.

**7 Risk** of implied authority: Since each partner acts as an agent of the firm, acts of one partner would bind the firm and all the remaining partners. A dishonest or incompetent partner may lend the firm into difficulties and the other partners may have to pay for it.

## Joint Hindu Family Firm

Joint Hindu Family firm is a unique form of business organisation prevailing only in India.

This is the firm belonging to joint hindu family and governed by the provisions of the Hindu Law.
Important features of the Joint Hindu Family Firm are :

I) Business is managed by the senior member of the family called Karta. Other members do not have the right to participate in the management of the firm.

2) Other members cannot question the authority of the Karta. Their only remedy is to get the family dissolved by mutual agreement.

**3)** Karta has the power to borrow funds for the business. The liability of the Karta is unlimited whereas the other coparceners are liable only to the extent of their share in the business.
4) If the Karta has misappropriated the funds of the business, he has to compensate the other coparcerlers to the extent of their shares in the joint property.

5) The death of any member of the family does not dissolve the business or the family.

6) Through mutual agreement the joint hindu family fim~ca n be dissolved.
You should note the difference between the joint Hindu family firm and the partnership
firm.

# COMPANY FORM OF ORGANISATION

You have learnt that sole proprietorships and partnerships have the disadvantages of limited resources, unlirpited liability, limited managerial skills, etc. The life and stability of these.organisations also depend on the life and srability of the proprietorslpartners.

In case of joint stock company, capital is contributed by not one or
two persons but by a number of persons called sliareholders. Thus, it is possible to raise large amount of capital. A joint stock company is an association of persons registered under Companies Act for carrying on some business. It is called an artificial person as it is created by law, with a distinctive name, a common seal and perpetual succession of members. It can sue and be sued in its own name.

## Main Features

Based on the above definitions, we can list out the features of the company form of organisation as follows :
**1** Incorporation: A company is an incorporated association. I1 comes into existence only
after registration under the Companies Act.

**2** Artificial person: A company is regarded as an artificial person as it is created by law and can be effaced only by law. It has no body, no soul, no conscience, still it is in a position to exist. Like any other person it can own property, conduct a lawful business,enter into contracts with others, buy, sell and hold property, all under its own name and its own seal.

**3** Separate legal entity: A company has a dislinct entity separate from its members. A shareholder of a cornpanp can enter into contract with the company and can sue the company and be sued by it. You know that in the case of partnership, every partner is an agent of the firm and also that of the other partners. But the shareholder is not the agent of the company or its shareholders.
**4** Common seal: As the company is not a natural person, it can not sign the documenls. It has a device in the form of common seal on which its name is engraved. This common seal is a substitute of its signatures. It is affixed on all important legal documents and contracts. It is used at the direction of the board of directors and two directors have to sign as witnesses wherever it is affixed on any document.

**5** Perpetual succession: A joint stock company has a continuous existence. Its life is no1 affected by the death, lunacy, insolvency or retirement of its shareholders or directors.

**6** Separation of ownership and management: The shareholders of a company are widely scattered throughout the country. For the conduct of the business and its management, shareholders elect another set ***of*** persons known as directors. The right to manage the company affairs is vested in the direclors who are elected representatives of the shareholders.

**7** Number of members: In the case of a public limited company: the minimum number is seven and there is no maximum limit. In the case of a private limited company, minimum number is two and the maximum is fifty.

**8** Limited liability: The liability of the members of a company is normally limited by guarantee or by the shares. Members liability is limited to the amount of shares held.

**9** Transferability **of** shares: The member of a public limited company enjoys a statutory right to sell his shares to others without the consent of other shareholders. But for transferring the shares he has to follow the procedure laid down in the Companies Act.

**10** Regidity of objects: The scope of the business of a company is limited. The type of business in which the company would participate is mentioned in the 'object clause' of its Memorandum of Association. The company cannot take up any new business without changing the object clause

**11** Statutory regulations: A company is governed by the Companies Act and it has to follow various provisions of the Act.

## Classification of Companies

**1** On the basis of the mode of incorporation, we can classify companies into three categories :
a) Statutory Company: A company established by a special Act of the Parliament or State Legislature is called 'Statutory Company'. Such companies are established in special cases when it is necessary to regulate the working of the company for some specific purposes. Examples of such corporations are Reserve Bank of India, Life Insurance Corporation of India, Air India Corporation, Food Corporation of India,etc.

### Classification of Companies

**a)** Registered Company: A coinpany which is incorporated through registration with the Registrar of Companies underJhe Companies Act, 1956, is called a 'RegisteredCompany'. This is also called 'In'corporated Company'. All companies established under the private sector belong to this category.
**b)** Chartered Company: A company which is incorporated under a special Royal Charter granted by the Monarch is called a 'Chartered Company'. It is regulated by the provisions of that charter.

**Based on the type of liability,** companies may be classified into three categories :
a) Unlimited Company : Company in which the liability of the members is unlimited, is called 'Unlimited Company'. At the time of winding up of the company shareholders have to pay, if necessary, from their personal assets to clear the company's debts. From this point of view, it is very much like sole proprietorship and partnership.

**b)** Companies Limited **by** Guarantee: In the case of some compainies, members give guarantee for the debts of the company up to a certain limit in addition to the amount of shares held by them.

C) Companies Limited by Shares: In this case the liability of the members is limited to the amount of the shares held by them. **A** shareholder can be called upon to pay only the unpaid amount of shares held by him and nothing more. Most of the companies come under this category.

**3** On the basis of the ownership, companies may be classified into three categories

**a) Private Limited Company**: A private limited company means a company which by its article

i) restricts the right to transfer its shares;

ii) limits the number of its members to fifty; and

iii) prohibits any invitation to the public to subscribe for any shares or debentures of the company.

**b) Public Limited Company**: **A** public limited company is one which is not a private limited company. **A** company having the following characteristics should be called a public limited company.

i) The right of the shareholder to transfer his shares is not restricted.

ii) The minimum number of shareholders is 7 but there is no limit to the maximum number of members.

iii) It can invite public to subscribe for its shares and debentures.

The minimum number of inembers in the case of a private limited cornpany is two and can be formed more easily as compared to a public company. It is exempted from various regulations of the Companies Act and thus combines the advantages of limited liability and the facilities of a partnership organisation. It is considered suitable for a medium sized business.

**C)** Government Company: A company in which not less than 5 1 per cent of the paid up share capital is held by the Central Government, or by any State Government or jointly by Central and/or State Governments.

**4** On the basis of the jurisdiction of the functioning, we can classify companies into two categories :

**a) National Company**: When the operations of a company are confined within the boundaries of the country in which it is registered, such a company is called a national company.

**b) Multinational Company**: When the operations of a company are extended beyond the boundaries of the country in which it is registered, such a company is called a multinational company. It is also called 'transnational company'.