Revision Notes

Class 11 - Business Studies

Chapter 2 - Forms Of Business Organization

Forms of business organisation

There are different forms of business organizations from which a choice has to be made:

1. Sole proprietorship
2. Joint Hindu family business
3. Partnership
4. Joint stock Company
5. Cooperative Societies

SOLE PROPRIETORSHIP

It is a form of organisation which is owned, managed and controlled by an individual who bears all the risk and receives all the profit.

Features

1. Formation and closure: It can be established and closed without any legal formalities.

2. Liability: The liability of the sole proprietor is unlimited in this form of business organisation.

3. Sole risk bearer and profit recipient: Being a sole owner, he bears all the risk and receives all the profits.

4. Control: All the decisions are taken and implemented in the organization by the owner.

5. No separate entity: Both owner and business are considered as one in the eyes of law.

6. Lack of business continuity: Business can be continued till the owner wishes to.

Merits

- **Quick decision making:** Prompt decision making as all the decisions are to be taken by the owner.

- **Confidentiality of information:** Being a sole owner, it is easy to maintain business secrecy.
- **Direct incentive:** All the profits are enjoyed by the owner as there is no one to share profits.
- **Sense of accomplishment:** Successful business provides satisfaction to the owner and sense of achievement.
- **Ease of formation and closure:** No legal formalities for formation and closure of business which makes it easy to start and end the business.

Limitations

- **Limited resources:** Business can be funded from savings of the owner or money borrowed from friends, relatives.
- **Limited life of a business concern:** Continuity of the business depends on the health and state of mind of the owner.
- **Unlimited liability:** In case business fails repayment of debts, his personal assets are at risk.
- **Limited managerial ability:** One person may not possess the ability to manage all the functions.

JOINT HINDU FAMILY BUSINESS

It is a form of business which is owned and managed by members of Hindu undivided family, with the possibility of three successive generations as members in the business.

Features

- **Formation:** Hindu Undivided Family is formed with at least two members of a family having ancestral property. It is governed by Hindu Succession Act, 1956.
- **Liability:** All the members of the family except Karta have limited liability up to their share in the business property.
- **Control:** All the activities in the business organization are controlled by Karta.
- **Continuity:** It can be discontinued if all the members of the family agree to do so.
- **Minor members:** Membership in the organization is by birth.

Merits

- **Effective control:** Complete control of business with 'Karta' thus effective decision making.
- **Continued business existence:** Business continues till all the members wish to continue and control is transferred to the next elder member in case

of death of 'Karta'.

- **Limited liability of members:** Members of the family enjoy liability limited to their share in the business party.
- **Increased loyalty and cooperation**: Family members have a sense of belongingness and loyalty, hence, all work with a common objective of growth.

Limitation

- **Limited resources:** Business can be funded mainly from ancestral property, hence limiting the financial resources.
- **Unlimited liability of Karta:** The personal property of 'Karta' is at risk as he has unlimited liability.
- **Dominance of Karta:** Difference of opinion among members and 'Karta' may cause conflict amongst them.
- **Limited managerial skills:** Karta may not have knowledge and expertise of all the functions performed in the business.

PARTNERSHIP

According to partnership Act 1932, partnership is the relation between persons who have agreed to share the profits of the business carried on by all or any one of them acting for all.

Features

- **Formation:** Business is established as per the provisions of partnership Act 1932.
- **Liability:** All the partners in the business have unlimited liability.
- **Risk bearing:** All the risk in the business is shared by all the partners.
- **Decision making and control:** All the decisions are taken in after the consent of all the partners and each partner shares responsibility of running business.
- **Continuity:** Continuity depends upon the partnership deed among the partners at the time of its formation.
- **Number of partners:** Minimum 2 and maximum 50 members [as per the Companies (miscellaneous) Rules 2014}, or maximum could be 100 (according to Companies Act, 2013).
- **Mutual agency:** Each partner is the owner as well as the agent of the firm and agent to other partners.

Merits

- **Ease of formation and closure:** Business can be established and closed

- **Balanced decision making:** All the decisions are taken by consent partners as partners undertake responsibilities as per their expertise.
- **More funds:** Funds are provided by all the partners, which increases the scope for large-scale business operation.
- **Sharing of risks:** Business risk and responsibilities are shared among all the partners.
- **Secrecy:** It is easy to maintain business secrecy as there is no need to submit financial results.

Limitations

- **Unlimited liability:** Each partner's liability is extended to their personal property.
- **Limited resources:** Availability of Finance is limited due to the restriction of number of partners.
- **Possibility of conflicts:** All the partners may have different opinions which create conflict among them.
- **Lack of continuity:** Any conflict between partners or death of a partner may bring business to an end.
- **Lack of public confidence:** It is difficult for an outsider to ascertain true financial position as there is a lack of availability of financial reports.

Types of Partners

- **Active partner:** A partner who contributes capital, shares profits and losses, participates in management and has unlimited liability.
- **Sleeping or dormant partner:** Partner who contributes capital, shares profits and losses and has unlimited liability but does not participate in management.
- **Secret partner:** This partner participates in management operations secretly, but does contribute in profits and losses.
- **Nominal partner:** Partner who does not contribute capital and does not share profit and losses but allows partnership business to project him or her as partner.
- **Partner by estoppel:** An individual who is not a partner but projects himself/herself as a partner to an outsider and has unlimited liability.
- **Partner by holding out:** An individual who is not a partner but is projected as a partner by other partners of the partnership firm and his liability is unlimited.

Partner	Contribution Of Capital	Management	Profit/Loss Sharing	Liability
Active	Yes	Yes	Yes	Unlimited
Sleeping	Yes	No	Yes	Unlimited
Secret	Yes	Yes, but secretly	Yes	Unlimited
Nominal	No	No	Generally Yes	Unlimited
Partner by Estoppel	No	No	No	Unlimited
Partner by Holding out	No	No	No	Unlimited

Minor as partner:
An individual of age below 18 years can be admitted with mutual consent of all other partners but legally he is not a partner.

Types of partnership
Partnership can be categorised on the basis of duration and liability:

Classification on the basis of duration
- **Partnership at will:** Partnership continues till the partners agree to do so.
- **Particular partnership:** The partnership formed for a specific task for project or for a specific period of time. It comes to an end after completion of task or expiry of time.

Classification on the basis of liability
- **General partnership:** Partnership where all partners have joint and unlimited liability

- **Limited partnership:** Partnership where all partners have limited liability and at least one partner must have unlimited liability.

Partnership deed

A written document where all the terms and conditions of partnership are mentioned. It generally has following clauses:

- Name of firm
- Nature of firm
- Duration of partnership
- Duties and obligations of partners
- Valuation of assets
- Interest on capital and interest on drawings
- Profit-loss sharing ratio
- Salaries and withdrawals of the partners.
- Preparation of accounts and their auditing.
- Procedure for dissolution of firm
- Method of solving disputes.

Registration

It is optional for a partnership firm to get registered with the registrar of firms of the state in which form is situated.

Consequences of non registration

- In case of non registration, a partner cannot file a case or file suit against other partners or the partnership firm.
- Firm cannot sue third parties.
- The form cannot file a case against one or more partners of the firm.

Procedure for getting firm registered

- Submission of application in prescribed form with the Registrar of Firms.
- Fee deposition with the Registrar.
- Receiving certificate of registration after the Registrar is satisfied.

COOPERATIVE SOCIETY

An organisation of voluntary people working for a common purpose with an aim to protect economic and social interests of the members. It must be registered under the Cooperative Societies Act, 1912.

Features

- **Voluntary membership:** Any individual irrespective of caste, gender, religion with common interest is free to join or leave a cooperative society as and when he/she desires.

- **Legal status:** Cooperative society has separate identity status distinct from its members, and the registration of such society is also mandatory.
- **Limited liability:** Members have liability limited to their capital contribution.
- **Control:** All the decision making power is in the hands of an elected managing committee which are chosen by members with one man one vote concept.
- **Service motive:** Society is formed with the motive of providing mutual help to team members.

Merits

- **Equality in voting status:** Each member has equal right to vote and elect members of the managing committee.
- **Limited liability:** The liability of members is limited to their capital contribution.
- **Stable existence:** Cooperative societies keep on going irrespective of situations of death, bankruptcy or insanity of its members.
- **Economy in operations:** The members of the society work voluntarily which helps in reducing costs.
- **Support from government:** Government provides support to societies in the form of lower taxes, interest rates and subsidies.
- **Ease of formation:** No legal formalities are involved in formation of societies.

Limitations

- **Limited resources:** Capital contribution by the member is the only source of finance, and low dividend also discourages members for the provision of finance to the society.
- **Inefficiency in management:** Members working on voluntary basis may lack necessary expertise and skills, leading to inefficiency in operations and management.
- **Lack of secrecy:** Difficult to maintain secrecy as members disclose all information related to work of the society in the meeting.
- **Government control:** Societies need to follow rules and regulations as stated by the government and submit audited financial reports of the society. However, such government intervention affects the freedom of work for such societies.
- **Differences of opinion:** Difference of opinion as a result of individual interest over the welfare may lead to conflicts amongst members.

Types of cooperative societies

- **Consumer's cooperative societies:** Societies formed for providing good quality services and products at a reasonable rate, to protect the interest of consumers.
- **Producer's cooperative societies**: Societies formed for providing good quality and low priced raw materials and other inputs, to protect the interest of producers.
- **Marketing cooperative societies:** Societies for providing services related to marketing of products by small producers.
- **Farmer's cooperative societies:** Societies formed for providing farmers with better inputs at reasonable rates to improve productivity.
- **Credit cooperative societies:** Societies established to provide financial assistance to its members at very reasonable terms.
- **Cooperative housing societies:** Societies formed for constructing houses for its members at reasonable cost.

JOINT STOCK COMPANY

The Companies Act, 2013 defines, "A company as an artificial person having a separate legal entity, perpetual succession and a common seal."

Features of a Joint Stock Company

- **Artificial person:** A company is created by law and has legal status but it does not function like human beings. All business activities are done by the board of directors in the name of the company.
- **Separate legal entity:** A company has its own identity distinct from its owner with the incorporation of a company.
- **Formation:** Company is formed by fulfilling all the legal formalities as stated under Companies Act, 2013.
- **Perpetual succession:** A company is created by law and can be wound up by law only. Existence of the company is not affected by the status of members.
- **Control:** Business affairs of a company are managed and controlled by the Board of Directors.
- **Liability:** A company has limited liability i.e., liability only to the extent of the capital contribution.
- **Common seal:** As a company is an artificial legal person, it cannot have a sign on its own/ Hence common seal acts as the official signature for a company. All the official documents must have a common seal for legal binding.
- **Risk bearing:** The risk of loss is shared by all the shareholders in proportion to their investment in the company.

Merits

- **Limited liability:** Shareholders liability is limited to the investment in the company, thus, there is no risk of losing personal assets.
- **Transfer of interest:** Shares can easily be sold in the market or can be converted into cash.
- **Perpetual existence:** Company's existence is not affected by the status of shareholders, company continues to exist.
- **Scope for expansion:** Companies can raise large amounts of funds from the public as well as borrowings from financial institutions or banks.
- **Professional management:** large-scale operation requires management by professionals and specialised individuals.

Limitations

- **Complexity in formation:** Formation of a company requires fulfilling of documentation and legal formalities which makes the procedure lengthy and complex.
- **Lack of secrecy:** All financial information is disclosed to the general public that there is no confidentiality or secrecy.
- **Impersonal work environment:** Business affairs are managed by professionals not owners, thus, it lacks personal contact with employees and customers.
- **Numerous regulations:** A company involves various rules and regulations which reduces freedom to work and involves a lot of money, time and effort.
- **Delay in decision making:** Decision making needs to follow a set of hierarchy which may cause delay in taking decisions and actions.
- **Oligarchic management:** Shareholders have very little control over the running of business, thus, the directors take all the decisions which may at times get influenced by their personal interest.
- **Conflict in interests:** It is difficult for management to satisfy everyone as there are too many stakeholders with diverse interests.

Types of Companies

a. **Private Company**

- A company must have minimum 2 or maximum 200 members.
- Right to transfer shares is restricted.
- Funds cannot be generated from the general public.
- Uses 'Private Limited' after the company name.

b. **Public Company**

- Minimum 7 members with no limit on maximum members.

- Free to transfer shares.
- Issue shares to the general public.
- Uses 'Public Limited' after the company name.

Difference between Public and Private Company

Basis	Public Company	Private Company
Members	Minimum: 7 members Maximum: Unlimited	Minimum: 2 members Maximum: 200
Minimum number of directors	3 directors	2 directors
Invitation to Public	Can invite public for subscription	Cannot invite public for subscription
Transfer of shares	Can transfer	Cannot transfer
Index of Members	Compulsory	Not compulsory

CHOICE OF FORM OF BUSINESS ORGANISATION

- **Cost and ease in setting up the organisation:** It is easy to start sole proprietorship with minimum cost and legal requirements whereas formation of a company is a complex task with lengthy legal procedure. But partnership has the advantage of less legal requirements with low cost.
- **Liability:** In sole proprietorship and partnership, the liability of owner or partners is unlimited but in cooperative societies and companies, members have limited liability.
- **Continuity:** In sole proprietorship and partnership, continuity is affected by death and insolvency of the owners but cooperative societies, companies and Hindu undivided family enjoy perpetual existence.
- **Management ability:** In sole proprietorship, it is difficult that the owner may have expertise in all functions but in other forms of business, division of work is possible which leads to better decision making.
- **Capital consideration:** In case of large scale of operation, company form is more suitable but in case of small scale of operation, partnership or sole proprietorship can be chosen.

- **Degree of control:** If the owner wants all the control in his hand the sole proprietorship may be preferred but if the owner is ready to share control, then he can adopt partnership or company form.
- **Nature of business:** For trading and services, sole proprietorship and partnership form can be chosen. For manufacturing, a company form of organisation can be adopted.