4

FORMS OF BUSINESS ORGANISATIONS

You have studied in the first lesson about Business, its significance and the classification of business activities. You are also aware that these activities are carried out by individuals in an organised form of a business enterprise, having different patterns of ownership and management. An individual may own the business or a number of individuals may come together to own the business jointly. So, based on ownership, we have different forms of business organisation like a proprietary concern, a partnership firm or a company. In this lesson, you will learn about the various forms of business organisation (excluding a joint stock company), their characteristics, merits and limitations, suitability and the steps involved in their formation.

LEARNING OUTCOMES

- describes the basic features of different forms of business organisations; and
- distinguishes between different forms of business organisations.

4.1 MEANING OF BUSINESS ORGANISATION

You have already learnt about the meaning of business and the various types of business activities like industry, trade, transport, banking, insurance etc. If you observe these business activities carefully, you will realise that whatever business activity one may take up, he/she has to bring together various resources like men, money, materials, methods, machines, technology, etc. to carry out that activity successfully. In addition, these resources are to be put into action in a systematic manner to achieve the objectives of business.

Let us take the example of a rice mill. First, the owner will have to acquire a land and construct a building or hire a factory building, buy machines and install them, employ labour to work, buy paddy and then process the paddy to produce rice that will be sold to the customers. Thus, to produce rice from paddy you need to assemble resources like land, building, machinery, labour etc., and put these resources together in action in a systematic way. Then only it becomes possible to produce rice and sell it to the customers and earn profit.

Thus, to carry out any business and achieve its objective of earning profit it is required to bring together all the resources and put them into action in a systematic way, and coordinate and control these activities properly. This arrangement is known as Business Organisation.

4.2 FORMS OF BUSINESS ORGANISATION

Have you ever thought who brings the required capital, takes the responsibility of arranging other resources, puts them into action, and coordinates and controls the activities to earn the desired profits? If you look around, you will find that a small grocery shop is owned and run by a single individual who performs all these activities. But, in big businesses, it may not be possible for a single person to perform all these activities. So, in such cases two or more persons join hands to finance and manage the business properly and share its profit as per their agreement. Thus, business organisations may be owned and managed by a single individual or group of individuals who may form a partnership firm or a joint stock company. Such arrangement of ownership and management is termed as a form of business organisation. A business organisation usually takes the following forms in India:

(1) Sole proprietorship

(2) Partnership

(3) Joint Hindu Family

(4) Cooperative Society

(5) Joint Stock Company

Let us now learn in detail the exact nature of these forms of business organisation, excluding Joint Stock Company which will be taken up in the next lesson.

Note

4.3 SOLE PROPRIETORSHIP

Gopal runs a grocery shop in the local market. He buys goods from the wholesale market and sells it to the customers as per their requirement. By doing so he earns some profit. He had started his business two years ago by investing Rs. 1 lakh, which he had borrowed from his friend. Today, he is running his business successfully, earning a reasonable profit, and has been able to pay back the borrowed money. He has also employed two persons to help him in the shop. Gopal says, he is the owner of a sole proprietor concern. Do you agree?

Before giving answer to this question, let us first know the exact nature of 'sole proprietorship'.

The term 'sole' means single and 'proprietorship' means 'ownership'. So, only one person is the owner of the business organisation. This means, that a form of business organisation in which a single individual owns and manages the business, takes the profits and bears the losses, is known as sole proprietorship form of business organisation.

So, you can say that Gopal is running a sole proprietorship business, and is known as a sole proprietor or a sole trader.

You must have seen many more such business organisations in and around your locality. Make a list of such concerns engaged in different types of businesses.

1. Supreme Drycleaners
2. ____________________
3. ____________________
4. ____________________
5. ____________________

Definition of Sole Proprietorship

J.L. Hanson has defined Sole Proprietorship as, "A type of business unit where one person is solely responsible for providing the capital and bearing the risk of the enterprise, and for the management of the business."

Thus, 'Sole Proprietorship' form of business organisation refers to a business enterprise exclusively owned, managed and controlled by a single person with all authority, responsibility and risk.

Now you can work out certain characteristics of sole proprietorship form of business organisation.

4.3.1 CHARACTERISTICS OF SOLE PROPRIETORSHIP FORM OF BUSINESS ORGANISATION

(a) **Single Ownership:** The sole proprietorship form of business organisation has a single owner who himself/herself starts the business by bringing together all the resources.

(b) **No Separation of Ownership and Management:** The owner himself/herself manages the business as per his/her own skill and intelligence. There is no separation of ownership and management as in case of company form of business organisation.

(c) **Less Legal Formalities:** The formation and operation of a sole proprietorship form of business organisation does not involve any legal formalities. Thus, its formation is quite easy and simple.

(d) **No Separate Entity:** The business unit does not have an entity separate from the owner. The businessman and the business enterprise are one and the same, and the businessman is responsible for everything that happens in his business unit.

(e) **No Sharing of Profit and Loss:** The sole proprietor enjoys the profits. At the same time, the entire loss is also borne by him. The profits and losses of the business are not shared by the proprietor. He alone bears the risks and reaps the profits.

(f) **Unlimited Liability:** The liability of the sole proprietor is unlimited. In case of loss, if the business assets are not enough to pay the business liabilities, his personal property can also be utilised to pay off the liabilities of the business.

(g) **One-man Control:** The controlling power of the sole proprietorship business always remains with the owner. He/she runs the business as per his/her own will.

Gopal is happy in running his business in sole proprietorship form because he enjoys many benefits in doing this business. At the same time, he also comes across many difficulties. Would you like to know the merits and limitations of this form of business organisation? Let us discuss.

4.3.2 MERITS OF SOLE PROPRIETORSHIP FORM OF BUSINESS ORGANISATION

(a) **Easy to Start and Wind Up:** It is very easy and simple to start a sole proprietorship form of business organisation. No legal formalities are required to be observed. Similarly, the business can be wound up any time if the proprietor so decides.

(b) **Quick Decision and Prompt Action:** As stated earlier, nobody interferes in the affairs of the sole proprietary organisation. So he/she can take quick decisions on various issues relating to business and accordingly prompt action can be taken.

(c) **Direct Motivation:** In sole proprietorship form of business organisation, the entire profit of the business goes to the owner. This motivates the proprietor to work hard and run the business efficiently.

(d) **Flexibility in Operation:** It is very easy to bring about changes as per the requirements of the business. The expansion or curtailment of business activities does not require many formalities as in the case of other forms of business organisation.

(e) **Maintenance of Business Secrets:** The business secrets are known only to the proprietor. He is not required to disclose any information to others unless and until he himself so decides. He is also not bound to publish his business accounts.

(f) **Personal Touch:** Since the proprietor himself handles everything relating to business, it is easy to maintain a good personal contact with the customers and employees. By knowing the likes, dislikes and tastes of the customers, the proprietor can adjust his operations accordingly. Similarly, as the employees are few and work directly under the proprietor, it helps in maintaining a harmonious relationship with them, and run the business smoothly.

Though sole proprietorship is a popular form of business organisation yet it suffers from various limitations, let us discuss.

4.3.3 LIMITATIONS OF SOLE PROPRIETORSHIP FORM OF BUSINESS ORGANISATION

(a) **Limited Resources:** The resources of a sole proprietor are always limited. Being the single owner it is not always possible to arrange sufficient funds from his own sources. Again borrowing funds from friends and relatives or from banks has its own implications. So, the proprietor has a limited capacity to raise funds for his business.

(b) **Lack of Continuity:** The continuity of the business is linked with the life of the proprietor. Illness, death or insolvency of the proprietor can lead to closure of the business. Thus, the continuity of business is uncertain.

(c) **Unlimited Liability:** You have already learnt that there is no separate existence of the sole proprietorship business from its owner. In the eyes of law the proprietor and the business are one and the same. So personal properties of the owner can also be used to meet the business obligations and debts.

(d) **Limited Managerial Expertise:** A sole proprietorship form of business organisation always suffers from lack of managerial expertise. A single person may not be an expert in all fields like, purchasing, selling, financing etc. Again, because of limited financial resources, and the size of the business it is also not possible to engage professional managers in sole proprietorship form of business organisations.

(e) **Not Suitable for Large Scale Operations:** Since, the resources and the managerial ability is limited, sole proprietorship form of business organisation is not suitable for large-scale business.

4.3.4 SUITABILITY OF SOLE PROPRIETORSHIP FORM OF BUSINESS ORGANISATION

You have learnt about the meaning, characteristics, merits and limitations of sole proprietorship form of business organisations. After such a detailed study, it should now be easier for you to identify areas in which sole proprietorship form of business organisation is most suitable. To assist you in such exercise, it can be stated that the sole proprietorship is suitable where:

- The market is limited, localised and the customers give importance to personal attention.
- The capital requirement is small and risk involved is limited.
- The production of goods involves manual skills e.g., handicrafts, filigree work, jewellery, tailoring, haircutting etc.

INTEXT QUESTION 4.1

1. Define 'Sole Proprietorship' in your own words.

2. Below are given the merits and limitations of sole proprietorship form of business organisation. Write 'M' against Merits and 'L' against Limitations in the space provided against each.

(a) A sole proprietorship business is easy to start. ( )

(b) A sole proprietor is personally liable for all the liabilities of the business. ( )

(c) A sole proprietor has a limited capacity to raise funds for his business. ( )

(d) A sole proprietor can maintain secrecy about the affairs of his business. ( )

(e) A sole proprietor maintains good personal contact with the customers. ( )

3. Match the following with reference to sole proprietorship business.

Column - A	Column - B
(a) Liability	(i) Easy
(b) Formation	(ii) minimum
(c) Resource	(iii) prompt
(d) Decision making	(iv) Unlimited
(e) Legal formalities	(v) Limited

4.4 PARTNERSHIP

A textile factory is going to be started in the nearby area where Gopal is carrying on his business. As a businessman, he is now in a jubilant mood. He is thinking that once the textile factory is set up, he will get more customers; the sales will increase and he will earn more profit. But, for all these, he will have to expand his business, and for this he needs more money. The major problem is how to arrange for additional funds. He has the option of getting a loan from the bank. But the fear of loss comes to his mind again and again. He does not want to take that risk. Another option is that he may join hands with some other person who is also keenly interested to join his business. By doing so, more resources can be raised, work can be shared, and business can run in a better way. The risk of loss will also be shared. But this involves a new form of business organisation known as Partnership organisation. To form partnership business, Gopal has to gain clarity on the exact nature of this form of business organisation, its pros and cons before he goes in for it.

Note

'Partnership' is an association of two or more persons who not only pool their financial and managerial resources but also agree to carry on a business, and share its profits or losses.

Let's assume that Gopal joins hand with Rahim to start a big grocery shop. Here both Gopal and Rahim are called partners who are running the partnership firm jointly. Both of them will pool their resources and carry on business by applying their expertise. They will share the profits and losses in the agreed ratio. In fact, for all terms and conditions of their working, they have to sit together to decide on all aspects. There must be an agreement between them. The agreement may be oral, written or implied. When the agreement is in writing it is termed as partnership deed. However, in the absence of an agreement, the provisions of the Indian Partnership Act 1932 shall apply.

Partnership form of business organisation in India is governed by the Indian Partnership Act, 1932, and section 4 of the Act defines partnership as "the relation between persons who have agreed to share the profits of the business, carried on by all or any of them, acting for all". Individually every person who joins the partnership is called a partner and collectively known as a firm.

4.4.1 CHARACTERISTICS OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

Based on the definition of partnership as given above, the various characteristics of partnership form of business organisation, can be summarised as follows:

(a) **Two or More Persons:** To form a partnership firm atleast two persons are required. As per the Rule 10 of the Companies Act 2013, the maximum limit on the number of persons is 100.

(b) **Contractual Relationship:** Partnership is created by an agreement among the persons who have agreed to join hands. Such persons must be competent to contract. Thus, minors, lunatics and insolvent persons are not eligible to become partners. However, a minor can be admitted to the benefits of partnership firm i.e., he can have a share in the profits without any obligation for losses.

(c) **Sharing Profits of Business:** There must be an agreement among the partners to share the profits and losses of the business of the partnership firm. If two or more persons share the income of jointly owned property, it is not regarded as partnership.

(d) Existence of Lawful Business: The business of which the persons have agreed to share the profit must be lawful. Any agreement to indulge in smuggling, black marketing etc. cannot be called partnership business in the eyes of law.

(e) Principal Agent Relationship: There must be a mutual agency relationship between the partners. Every partner is the principal as well as the agent of the firm. When a partner deals with other parties he/she acts as an agent of other partners, and at the same time the other partners become the principal.

(f) Unlimited Liability: The partners of the firm have unlimited liability. They are jointly as well as individually liable for the debts and obligations of the firms. If the assets of the firm are insufficient to meet the firm's liabilities, the personal properties of the partners can also be utilised for this purpose. However, the liability of a minor partner is limited to the extent of his share in the profits.

(g) Voluntary Registration: The registration of partnership firm is not compulsory.But an unregistered firm suffers from some limitations which makes it virtually compulsory to be registered. Following are the limitations of an unregistered firm:

i. The firm cannot sue third party, although a third party can sue it.

ii. In case of any dispute among the partners, it is not possible to settle the dispute through court of law.

iii. The firm cannot claim adjustments for amount payable to, or receivable from, any other parties.

4.4.2 MERITS OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

(a) Easy to Form: A partnership can be formed easily without many legal formalities. Since it is not compulsory to get the firm registered, a simple agreement, either in oral, writing or implied is sufficient to create a partnership firm.

(b) Availability of Larger Resources: Since two or more partners join hands to start partnership firm it may be possible to pool more resources as compared to sole proprietorship form of business organisation.

(c) Better Decisions: In partnership firm each partner has a right to take part in the management of the business. All major decisions are taken in consultation with and with the consent of all partners. Thus, collective wisdom prevails and there is less scope for reckless and hasty decisions.

(d) **Flexibility:** The partnership firm is a flexible organisation. At any time the partners can decide to change the size or nature of business or area of its operation after taking the necessary consent of all the partners.

(e) **Sharing of Risks:** The losses of the firm are shared by all the partners as per the agreed ratio.

(f) **Keen Interest:** Since partners share the profit and bear the losses, they take keen interest in the affairs of the business.

(g) **Benefits of Specialisation:** All partners actively participate in the business as per their specialisation and knowledge. In a partnership firm providing legal consultancy to people, one partner may deal with civil cases, one in criminal cases, another in labour cases and so on as per their area of specialisation.

(h) **Protection of Interest:** In partnership form of business organisation, the rights of each partner and his/her interests are fully protected. If a partner is dissatisfied with any decision, he can ask for dissolution of the firm or can withdraw from the partnership.

(i) **Secrecy:** Business secrets of the firm are only known to the partners. It is not required to disclose any information to the outsiders. It is also not mandatory to publish the annual accounts of the firm.

(j) **Tax advantage:** The share of profits in the firm is exempt from tax in the hands of partners. If there is a registered partnership deed, the firm can take the benefits of reducing tax liability under the provisions of Income-Tax Act1961.

Having learnt about the nature and merits of the partnership form of business organisation, now Gopal has decided to expand his business by starting a partnership form of business. One day, in a happy mood, he met Rahim (who also runs a grocery shop in the same locality) and explained to him about the concept, characteristics and merits of partnership form of business organisation. Rahim heard Gopal very carefully and asked Gopal about the limitations (if any) of this form of business organisation. Gopal had no idea about any limitations. Gopal also observed that Rahim looked hesitant. Let him now have an idea about the limitations of partnership form of business organisation and also know what are the various types of partners that can be admitted.

4.4.3 LIMITATIONS OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

A partnership firm also suffers from certain limitations. These are as follows:

(a) **Unlimited Liability:** The liability of the partners is unlimited i.e., the partners are personally liable for the debt and obligations of the firm. In other words, their personal property can also be utilised for payment of firm's liabilities incase the firm's assets are insufficient to pay debts.

(b) **Instability:** Every partnership firm has an uncertain life. The death, insolvency, incapacity or the retirement of any partner brings the firm to an end. Not only that, any dissenting partner can give notice at any time for dissolution of partnership.

(c) **Limited Capital:** Since the total number of partners cannot exceed 100, the capacity to raise funds remains limited as compared to a joint stock company where there is no limit on the number of share holders.

(d) **Non-transferability of share:** The share of interest of any partner cannot be transferred to other partners or to the outsiders. So it creates inconvenience for the partner who wants to transfer his share to others fully or partly. The only alternative is dissolution of the firm.

(e) **Possibility of Conflicts:** In partnership firm every partner has an equal right to participate in the management. Also, every partner can place his or her opinion or viewpoint before the management regarding any matter at any time. Because of this, sometimes there is friction and conflict among the partners. Difference of opinion may give rise to conflicts and lead to dissolution of the firm.

4.4.4 TYPES OF PARTNERS AND PARTNERSHIP

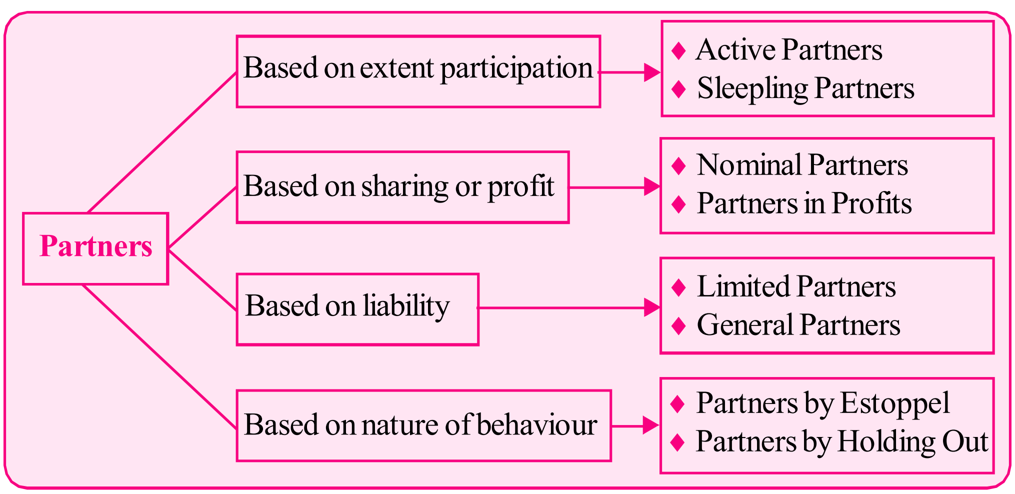

Fig.: 4.1

Types of Partners

You have learnt that generally every partner in a firm contributes to its capital, participates

Note

in the day-to-day management of firm's activities, and shares its profits and losses in the agreed ratio. In other words all partners are supposed to be active partners. However, in certain cases there are partners who play a limited role. They may contribute capital and such partners cannot be termed as active partners. Similarly, some persons may simply lend their name to the firm and make no contribution to capital of the firm. Such persons are partners only in name. Thus, depending on the extent of participation and the sharing of profits, liability etc., partners can be classified into various categories. These are summarised as under.

(A) **Based on the extent of participation** in the day-to-day management of the firm, partners can be classified as:

   a. **'Active Partners':** The partners who actively participate in the day-to-day operations of the business are known as active partners or working partners.

   b. **'Sleeping Partners':** Those partners who do not participate in the day-to-day activities of the business are known as sleeping or dormant partners. Such partners simply contribute capital and share the profits and losses.

(B) **Based on sharing of profits,** the partners may be classified as:

   a. **'Nominal Partners':** Nominal partners allow the firm to use their name as partner. They neither invest any capital nor participate in the day-to-day operations. They are not entitled to share the profits of the firm. However, they are liable to third parties for all the acts of the firm.

   b. **'Partners in Profits':** A person who shares the profits of the business without being liable for the losses is known as 'partner in profits'. This is applicable only to the minors who are admitted to the benefits of the firm and their liability is limited to their capital contribution.

(C) **Based on Liability,** the partners can be classified as:

   a. **'Limited Partners':** The liability of limited partners is limited to the extent of their capital contribution. This type of partners are found in Limited Partnership firms in some European countries and the USA.

   b. **'General Partners':** The partners having unlimited liability are called 'general partners' or Partners with unlimited liability. It may be noted that every partner who is not a limited partner is treated as a general partner.

(D) **Based on the behaviour and conduct exhibited,** there are two more types of partners besides the ones discussed above.

Note

(a) **Partner by Estoppel:** A person, who by his/her conduct or behaviour in the public gives an impression that he/she is a partner of the firm, is called 'partner by estoppel'. Such partners are not entitled to share the profits of the firm, but are fully liable if somebody suffers because of their false representation.

(b) **Partner by Holding out:** Similarly, if a partner or partnership firm declares that a particular person is a partner of their firm, and such a person does not disclaim it, then he/she is known as 'Partner by Holding out'. Such partners are not entitled to profits but are fully liable as regards the firm's debts.

Types of Partnership

Partnership can be categorised as under:

1. **General and Limited Partnership:** In the general partnership, the liability of the partners is unlimited, whereas limited partnership has two types of partners: General Partner and Special Partner. Liability of general partner is unlimited whereas liability of special partner is limited. There should be at least one general partner in the limited partnership firm.

2. **Partnership at Will and Particular Partnership:** Partnership at will can be formed to run the business for an indefinite period, while particular partnership can be formed for some specific purpose or duration and it ends with the attainment of pre-determined specific purpose or time period.

3. **Legal and Illegal Partnership :** Although it is not essential to get the partnership registered under Indian Partnership Act, 1932 in order to bring it into existence, yet the partnership organisations have to work in accordance with the provisions of the Indian Partnership Act, 1932 . Those partnerships which work according to the provisions of the Indian Partnership Act, 1932 are considered as legal and those which do not work according to the provisions of the above mentioned Act are called illegal partnerships.

One of Gopal's friends Rahul comes to his shop and sits there for hours together. In Gopal's absence, he attends to the customers and deals with his suppliers. Under the impression that Rahul is a partner (although he is not), a supplier finalised a deal which Gopal does not accept. In the process, the supplier suffers some loss. Can he claim the compensation from Rahul? What type of partner Rahul is?

4.4.5 SUITABILITY OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

We have already learnt that persons having different ability, skill or expertise can join hands to form a partnership firm to carry on the business. Business activities like construction, providing legal services, medical services etc. can be successfully run under this form of business organisation. It is also considered suitable whereas capital requirement is of a medium size. Thus, business like a wholesale trade, professional services, mercantile houses and small manufacturing units can be successfully run by partnership firms.

4.4.6 PARTNERSHIP DEED

A partnership deed, also known as partnership agreement, is a written document that outlines in detail the rights and responsibilities of all partners in a business operation. For lasting relationship among partners, there must be a written agreement among the partners to carry out the business and share the profits and losses.

The deed must be in writing, duly signed by all the partners properly stamped except a minor who has been admitted to the benefits of partnership and properly stamped to take the benefits of tax. The agreement, i.e., the partnership deed must contain the following:

(i) The name of the firm

(ii) The nature of the business

(iii) The names and addresses of the partners

(iv) Location of business

(v) The term or duration of partnership, if decided

(vi) The amount of capital to be contributed by each partner

(vii) The ratio in which the profits and losses are to be shared among the partners

(viii) Rights and duties of partners.

(ix) Remuneration to partners and the timing and amount of withdrawals of cash by the partners

(x) The interest to be allowed on capital and charge on drawings.

(xi) Treatment of goodwill.

Note

(xii) Preparation of accounts and their auditing.

(xiii) Procedure for dissolution of the firm etc.

(xiv) Procedure for settlement of disputes

(xv) Arbitration clause.

4.4.7 RULES APPLICABLE IN THE ABSENCE OF AN AGREEMENT

Often, you find that two or more friends having very good relations and utmost good faith voluntarily agree to run a business without any written agreement. Over the years when business starts earning huge profit or incurs substantial loss, then dispute arises regarding its sharing impacting good relations resulting in dissolution of partnership firm. Then what will you do to settle the dispute in the absence of any written agreement. Hence, you must be aware of the provisions and rules applicable in the absence of partnership deed to settle the dispute These are as follows:

(a) Profit or losses of the firm will be shared equally by the partners.

(b) Interest on capital will not be allowed to any partner. (If agreed, the interest will be allowed only out of available profits of the firm. In case of losses no interest will be allowed.)

(c) No interest will be charged on withdrawals made by the partners.

(d) Partners will be allowed an interest @6% on the loan given to the firm.

(e) No salary or remuneration will be allowed to any of the partner.

(f) Every partner must take part in the management of the business.

Hence, the partners should get their firm registered with the Registrar of Firms of the concerned state. Although registration is not compulsory, but to avoid the consequences of non-registration, it is advisable to get it registered when it is setup or at any time during its existence to avail the benefits of tax.

The procedure for registration of a firm is as follows.

a. The firm will have to apply to the Registrar of Firms of the concerned state in the prescribed form.

b. The duly filled in form must be signed by all the partners.

c. The filled in form along with prescribed registration fee must be deposited in the office of the Registrar of Firms.

Note

d. The Registrar will scrutinise the application, and if then are satisfied that all formalities relating to registration have been duly complied with, they will put the name of the firm in his register and issue the Certificate of Registration.

INTEXT QUESTIONS 4.2

1. State the position of minors in relation to a partnership firm.

2. Following are the statements related to partnership form of business organisation. Rewrite the statement in correct form if found wrong.

   (a) Maximum 20 partners can join in a partnership firm running banking business.

   (b) Partnership Deed may be either oral or in writing.

   (c) There is an employer-employee relationship among the partners.

   (d) In a partnership firm Hari and Madhu contributed Rs. 10,000 each. Madhu's liability would be limited to Rs. 10,000 in case of losses in firm's business.

   (e) A person acquired interest in a partnership firm by virtue of his relationship with the existing partners.

3. Identify the type of partners in the following situation:

   (a) The liability of Sridhar, a 25 years old partner is limited to the extent of his capital contribution.

   (b) Madan has neither contributed any capital nor shares the profits of the firm though he is treated as a partner.

   (c) Sunita has been admitted to the benefits of the firm at the age of 15.

   (d) Sudhir had contributed to capital and shares the profit and loss of the firm. But he does not take part in the day-to-day activities.

   (e) A firm declares that Sachin is a partner of their firm. Knowing the declaration Sachin did not disclaim it.

Gopal is now running the partnership firm along with Rahim as a partner.They are earning good profit and managing their business smoothly. Gopal's father also runs a wholesale business in the same locality. That business was earlier being managed by Gopal's grandfather. One-day Gopal's father revealed that Gopal and his younger brother and sister have an equal share in his wholesale business. It is a family business and Gopal can continue his own partnership business without losing his position in this

Note

family business. Gopal was confused. His father explained to him that under Hindu Law it is a Joint Hindu Family business. Let us know in detail about Joint Hindu Family form of business organisation.

4.5 JOINT HINDU FAMILY (JHF) FORM OF BUSINESS ORGANISATION

After knowing about sole proprietorship and partnership forms of business organisation let us now discuss about a unique form of business organisation that prevails only in India and that too among the Hindus. The Joint Hindu Family (JHF) business is a form of ancestral business organisation run by Hindu Undivided Family (HUF) where the family members of three successive generations own the business jointly. The head of the family is known as Karta who manages the business. The other members are called co-parceners and all of them have equal ownership right over the properties of the business. It is to be noted here that if any income has been earned by any member of the joint Hindu Family because of his personal skills or traits, then such income will not be treated as income of HUF.

The membership of the JHF is acquired by virtue of birth in the same family. There is no restriction for minors to become the members of the business

4.5.1 CHARACTERISTICS OF JHF FORM OF BUSINESS ORGANISATION

From the above discussion, it must have been clear to you that the Joint Hindu family business has certain special characteristics which are as follows:

(a) **Formation:** In JHF business there must be at least two members in the family, and family should have some ancestral property. It is not created by an agreement. No legal formalities are required for its establishment. But it has to be registered with the Income tax department to avail the tax concessions involved.

(b) **Legal Status:** The JHF business is a jointly owned business. It is governed by the Hindu Succession Act 1956*.

(c) **Membership:** In JHF business outsiders are not allowed to become the co-parcener. Only the members of undivided family acquire co-parcenership rights by birth.

(d) **Profit Sharing:** All co-parceners have equal share in the profits of the business.

(e) **Management:** The business is managed by the senior most member of the family known as Karta. Other members do not have the right to participate in

*The Hindu Succession (Amedment) Act, 2005

Note

the management. The Karta has the authority to manage the business as per his own will and his ways of managing cannot be questioned. If the co-parceners are not satisfied, the only remedy is to get the HUF status of the family dissolved by mutual agreement.

(f) **Liability:** The liability of co-parceners is limited to the extent of their share in the business. But the Karta has an unlimited liability. His personal property can also be utilised to meet the business liability.

(g) **Continuity:** Death of any co-parceners does not affect the continuity of business.Even on the death of the Karta, it continues to exist as the eldest of the co-parceners takes position of Karta. However, JHF business can be dissolved either through mutual agreement or by partition suit in the court.

4.5.2 MERITS OF JHF FORM OF BUSINESS ORGANISATION

Since Joint Hindu Family business has certain peculiar features as discussed above, it has the following merits.

(a) **Assured Shares in Profits:** Every co-parcener is assured of an equal share in the profits irrespective of his participation in the running of the business. This safeguards the interest of the minor, sick and physically and mentally challenged co-parceners.

(b) **Quick Decision:** The Karta enjoys full freedom in managing the business. It enables him to take quick decisions without any interference.

(c) **Sharing of Knowledge and Experience:** A JHF business provides opportunity for the young members of the family to get the benefits of knowledge and experience of the elder members. It also helps in inculcating virtues like discipline, self-sacrifice, tolerance etc.

(d) **Limited Liability of Members:** The liability of the co-parceners except the Karta is limited to the extent of their share in the business. This enables the members to run the business freely just by following the instructions or direction of the Karta.

(e) **Unlimited Liability of the Karta:** Because of the unlimited liability of the Karta, his personal properties are at stake in case the business fails to pay the creditors. This clause of JHF business enables the Karta to manage business most carefully and efficiently.

(f) **Continued Existence:** The death or insolvency of any member does not affect the continuity of the business. So it can continue for a long period of time.

Note

(g) **Tax Benefits:** HUF is regarded as an independent assessee for tax purposes.The share of co-parceners is not to be included in their individual income for tax purposes.

After knowing the merits let us see the limitations of Joint Hindu Family as form of business organisation.

4.5.3 LIMITATION OF JHF FORM OF BUSINESS ORGANISATION

(a) **Limited Resources:** JHF business has generally limited financial and managerial resources. Therefore, it is not considered suitable for large business.

(b) **Lack of Motivation:** The co-parceners get equal share in the profits of the business irrespective of their participation. So generally, they are not motivated to put in their best.

(c) **Scope for Misuse of Power:** Since the Karta has absolute freedom to manage the business, there is scope for him to misuse it for his personal gains. Moreover, he may have his own limitations.

(d) **Instability:** The continuity of JHF business is always under threat. A small rift within the family may lead to seeking partition.

4.5.4 SUITABILITY OF JHF FORM OF BUSINESS ORGANISATION

The Joint Hindu Family form of business organisation is suitable where the family inherits a running business and the members of the family want to continue that business jointly as a family business. Even otherwise, this form of business organisation is considered suitable for a business that requires limited financial and managerial resources and having a very limited area of operation. It is found that JHF are usually engaged in trading business, indigenous banking, small industry, and crafts etc.

INTEXT QUESTIONS 4.3

1. Why should the liability of Karta be unlimited? State the liability of the members of a Joint Hindu Family business.

2. State whether it is a merit or a limitation of Joint Hindu Family business. Write 'M' for merit and 'L' for limitation in the box given against each statement.

   (a) Young family member gains knowledge and experiences from other members.

   (b) The death or insolvency of member does not affect the continuity of the business.

(c) The co-parceners are not motivated to put their best efforts.

(d) The members get equal share in the profits irrespective of their participation.

(e) The Karta takes quick decision without any interference.

3. Distinguish between partnership and Joint Hindu Family business on the basis of membership.

4.6 COOPERATIVE SOCIETY

You have learnt about Sole Proprietorship and Partnership as different forms of business organisation. You must have noticed that while there are many differences among them in respect of their formation, operation, capital contribution and liabilities. There is one similarity that both are engaged in business to earn profit. However, there are certain organisations which undertake business activities with the prime objective of providing service to the members. Although they also earn some amount of profit, but their main intention is to look after some common interest of its members. They pool available resources from the members, utilise the same in the best possible manner and share the benefits. These organisations are known as Co-operative Societies. Let us learn in detail about this form of business organisation.

The Section 4 of the Indian Cooperative Societies Act 1912 defines Cooperative Society as "a society, which has its objectives for the promotion of economic interests of its members in accordance with cooperative principles."

The term cooperation is derived from the Latin word 'co-operari', where the word 'Co' means 'with' and 'operari' mean 'to work'. Thus, the term cooperation means working together. So those who want to work together with some common economic objectives can form a society, which is termed as a cooperative society.

It is a voluntary association of persons who work together to promote their economic interest. It works on the principle of self-help and mutual help. The primary objective is to provide support to the members. People come forward as a group, pool their individual resources, utilise them in the best possible manner and derive some common benefits out of it.

4.6.1 CHARACTERISTICS OF COOPERATIVE SOCIETY

Based on the above definition we can identify the following characteristics of cooperative society as form of business organisation:

(a) **Voluntary Association:** Members join the cooperative society voluntarily i.e.by their own choice. Persons having common economic objective can join the society

Note

as and when they like, continue as long as they like and leave the society as and when they want.

(b) Open Membership: The membership is open to all those having a common economic interest. Any person can become a member irrespective of his/her caste, creed, religion, colour, sex etc.

(c) Number of Members: A minimum of 10 members are required to form a cooperative society. In case of multi-state cooperative societies the minimum number of members should be 50 from each state in case the members are individuals. The Cooperative Society Act does not specify the maximum number of members for any cooperative society. However, after the formation of the society, the members may specify the maximum member of members.

(d) Registration of the Society: In India, cooperative societies are registered under the Co-operative Societies Act 1912 or under the State Cooperative Societies Act. The Multi-state Cooperative Societies are registered under the Multi-state Cooperative Societies Act 2002. Once registered, the society becomes a separate legal entity and attains certain characteristics. These are as follows:

(i) It enjoys perpetual succession

(ii) It has its own common seal

(iii) It can enter into agreements with others

(iv) It can sue others in a court of law

(v) It can own properties in its name

(e) State Control: Since registration of cooperative societies is compulsory, every cooperative society comes under the control and supervision of the government. The cooperative department keeps a watch on the functioning of the societies. Every society has to get its accounts audited from the cooperative department of the government.

(f) Capital: The capital of the cooperative society is contributed by its members. Since, the members contribution is very limited, it often depends on loan from the government and apex cooperative institutions or by way of grants and assistance from state and central government.

(g) Democratic Set Up: The cooperative societies are managed in a democratic manner. Every member has a right to take part in the management of the society.

However, the society elects a managing committee for its effective management. The members of the managing committee are elected on the basis of one-man one-vote irrespective of the number of shares held by any member. It is the general body of the society which lays down the broad framework within which the managing committee functions.

(h) **Service Motive:** The primary objective of all cooperative societies is to provide services to its members.

(i) **Return on Capital Investment:** The members get return on their capital investment in the form of dividend.

(j) **Distribution of Surplus:** After giving a limited dividend to the members of the society, the surplus profit is distributed in the form of bonus, keeping aside a certain percentage as reserve and for general welfare of the society.

4.6.2 TYPES OF COOPERATIVE SOCIETIES

You know co-operative organisations are set up in different fields to promote the economic well-being of different sections of the society. So, according to the needs of the people, we find different types of cooperative societies in India. Some of the important types are given below.

(a) **Consumers' Cooperative Societies:** These societies are formed to protect the interest of consumers by making available consumer goods of high quality at reasonable prices.

(b) **Producer's Cooperative Societies:** These societies are formed to protect the interest of small producers and artisans by making available items of their need for production, such as raw materials, tools, equipment etc.

(c) **Marketing Cooperative Societies:** To solve the problem of marketing the products, small producers join hands to form marketing co-operative societies.

(d) **Housing Cooperative Societies:** To provide residential houses to the members,housing cooperative societies are formed generally in urban areas.

(e) **Farming Cooperative Societies:** These societies are formed by the small farmers to get the benefits of large-scale farming.

(f) **Credit Cooperative Societies:** These societies are started by persons who are in need of credit. Credit Cooperative Societies accept deposits from the members and grant them loans at a reasonable rate of interest.

Note

4.6.3 MERITS OF COOPERATIVE SOCIETY

The cooperative society is the only form of business organisation which gives utmost importance to its members rather than maximising its own profits. After studying its characteristics and different types, we may now study the merits of this form of business organisation.

(a) **Easy to Form:** Any ten adult members can voluntarily form an association and get it registered with the Registrar of Cooperative Societies. The registration is very simple and it does not require much legal formalities.

(b) **Limited Liability:** The liability of the members of the cooperative societies is limited upto their capital contribution. They are not personally liable for the debt of the society.

(c) **Open Membership:** Any competent like-minded person can join the cooperative society any time he likes. There is no restriction on the grounds of caste, creed, gender, colour etc. The time of entry and exit is also generally kept open.

(d) **State Assistance:** The need for country's growth has necessitated the growth of the economic status of the weaker sections. Therefore, cooperative societies always get assistance in the forms of loans, grants, subsidies etc. from the state as well as Central Government.

(e) **Stable Life:** The cooperative society enjoys the benefit of perpetual succession.The death, resignation, insolvency of any member does not affect the existence of the society because of its separate legal status.

(f) **Tax Concession:** To encourage people to form cooperative societies, the government generally provides tax concessions and exemptions which keep on changing from time to time.

(g) **Democratic Management:** The cooperative societies are managed by the Managing Committee, which is elected by the members. The members decide their own rules and regulations within the limits set by the law.

4.6.4 LIMITATIONS OF COOPERATIVE SOCIETY

Although the basic aim of forming a cooperative society is to develop a system of mutual help and cooperation among its members, yet the feeling of cooperation does not remain for long. Cooperative societies usually suffer from the following limitations:

(a) **Limited Capital:** Most of the cooperative societies suffer from lack of capital.Since the members of the society come from a limited area or class and usually have limited means, it is not possible to collect huge capital from them. Again, government's assistance is often inadequate for them.

(b) **Lack of Managerial Expertise:** The Managing Committee of a cooperative society is not always able to manage the society in an effective and efficient way due to lack of managerial expertise. Again, due to lack of funds they are also not able to derive the benefits of professional management.

(c) **Less Motivation:** Since the rate of return on capital investment is less, the members do not always feel involved in the affairs of the society.

(d) **Lack of Interest:** Once the first wave of enthusiasm to start and run the business is exhausted, intrigue and factionalism arise among members quite frequently. This makes the cooperative lifeless and inactive.

(e) **Corruption:** In spite of government's regulation and periodical audit of the accounts of the cooperative society, the corrupt practices in the management cannot be completely ignored.

4.6.5 SUITABILITY OF COOPERATIVE SOCIETY

You have already learnt that cooperative society form of business organisations is a voluntary association of persons who are not financially to start and run the business individually. So to solve this problem or to meet the common requirements, this form of business organisation is most suitable. Thus, people can join hands to get the consumer products, to build residential houses, for marketing the products, to provide loans and advances etc. This form of business organisation is generally suitable for small and medium-sized business operation.

INTEXT QUESTIONS 4.4

1. Define 'Cooperative Society' in your own words.

2. Answer the followings in one or two words.

   (a) Who manages the cooperative society?

   (b) How many members are required to start a multistate cooperative society?

   (c) Which type of cooperative society is formed to solve the credit need of the people?

   (d) To whom the application should be made for seeking registration of a cooperative society?

(e) What is the maximum limit of membership in a cooperative society?

3. Match the following:

Column A	Column B
(a) Registration	(i) Limited
(b) Membership	(ii) Management
(c) Return on capital	(iii) Open to all
(d) Democratic	(iv) Compulsory
(e) Liability	(v) Dividend

TERMINAL EXERCISE

Very Short Answer Questions

1. Define sole proprietorship.
2. List any two situations in which sole proprietorship form of business organisation is found to be most suitable
3. Who is a partner by estoppel?
4. Distinguish between partnership and sole proprietorship business on the basis of membership.
5. State the meaning of the term 'Coparcener'.

Short Answer Questions

6. State the suitability of sole proprietorship form of business organisation.
7. Explain any two limitations of partnership form of business organisation.
8. What is meant by 'partnership deed'? Is it essential for partnership?
9. Compare the status of a minor in partnership firm with that in a Joint Hindu Family business.
10. Mention any four characteristics a cooperative society attains after getting the registration certificate.

Long Answer Questions

11. Describe any four different types of partners.

12. What is a Joint Hindu Family business? Describe its main characteristics.
13. Explain the various merits of a Joint Hindu Family form of business organisation.
14. Give the definition of cooperative society as per the Indian Cooperative Societies Act.1912.
15. State any two characteristics of cooperative society form of business organisation.
16. State the different types of cooperative societies that exist in India.
17. There is a saying that it is always better to have a written agrement. Keeping in view this saying it is always advisable for partners to have a written agreement. What is the name of this agreement and what are its contents in general?
18. You have gone through the various forms of business organisations. If you get an opportunity to start a business in the present scenerio which form of business organisation will you choose & why? Express your views with valid points.

ANSWER KEY OF INTEXT QUESTIONS

4.1	2.	(a) M	(b) L	(c) L	(d) M	(e) M
	3.	(a) iv	(b) i	(c) v	(d) iii	(e) ii

4.2 1. A minor can only share the profits of the business.

2. (a) Maximum 10 members can join a banking business in partnership form.

   (b) Partnership deed is always in the writing form.

   (c) There is a principal-agent relationship among the partners.

   (d) In a partnership Hari and Madhu contributed Rs. 10,000 each. Madhus's liability would be unlimited in case of losses in firm's business..

   (e) A person can acquire interest in a partnership firm by entering into an agreement.

3. (a) Limited partner

   (b) Nominal Partner

(c) Partner in profit or Minor partner

(d) Sleeping Partner/dormant partner

(e) Partner by holding out.

4.3 1. Since Karta has absolute power to manage the business as per his own will, he may misuse the authority for his personal gain. The clause unlimited liability restricts the Karta to do harm to the business.

2. (a) M (b) M (c) M (d) M (e) M

3. (a) Minimum two members are required in both the cases.

(b) Maximum 10 for banking and 20 for other business in case of partnership. Whereas there is no such limit fixed for Joint Hindu Family business.

(c) Membership is acquired by entering into agreement in partnership business. In Joint Hindu Family the membership is acquired by virtue of birth in the same family.

4.4 2. (a) Managing committee

(b) 50 (Individual members)

(c) Credit Cooperative society

(d) Registrar of Cooperative societies

(e) Maximum limit is not fixed by the Act. It is the members who can decide about the maximum limit of membership in the society if they so want.

3. (a) - (iv) (b) - (iii) (c) - (v) (d) - (ii) (e) - (i)

DO AND LEARN

1. Make a survey of twenty business organisations in and around your locality. Classify them under the four categories you have learnt in this lesson. Analyse their nature of business, size of the business, number of owners etc. in a tabular form.

2. Based on the above discussion as well as your understanding so far about the cooperative society form of business organisation, try to fill up the following table.

Types of cooperative society	Who forms the society	Objective of the society	Function of the society
1. Consumers'cooperative societies			
2. Producers' cooperative societies			
3. Marketing cooperative societies			
4. Housing cooperative societies			
5. Farming cooperative societies			
6. Credit cooperative societies			

ROLE PLAY

1. Rajesh runs a tailor shop successfully. With time his clients are increasing. Now he wants to expand his business and open a retail shop for readymade garments. He wants to offer his friend, Kamal a partnership in his business. His wife suggests to continue as a sole proprietor .

   The following is the conversation between Rajesh and his wife.

   Rajesh: I feel overburdened with the growing business so I am thinking of entering into a partnership with my friend.

   Wife: I am happy that you want to expand the business but partnership is not the only option.

   Rajesh: What do you suggest ? Why are you not interested in partnership?

   Wife: Employ a manager instead of entering into partnership

   (Rajesh talked about the merits of partnership and limitations of sole proprietorship; whereas his wife highlighted the merits of expanding the business by hiring employees and limitations of partnership). Put yourself in place of Rajesh and a friend in place of his wife and continue the dialogue.

WHAT HAVE YOU LEARNT