



215en03

## MODULE - II

Maximum Marks

15

Hours of Studies

35

### Forms of Business Organisation

On the basis of to size, ownership and managerial requirements business units have a defined organizational structure. After studying this module the learners shall be able to classify the business enterprises into various forms of organization like Sole Proprietorship, Partnership Firms, Hindu Undivided Family, Cooperative Societies and Joint Stock Companies.

- Lesson 3** : **Sole Proprietorship, Partnership & Hindu Undivided Family**
- Lesson 4** : **Cooperative Societies and Joint Stock Companies**



## 3

## SOLE PROPRIETORSHIP, PARTNERSHIP & HINDU UNDIVIDED FAMILY

We go to the market to buy items of our daily need. In the market, we find a variety of shops, some of them small and some of them big. We may see some persons selling vegetables, rice, pulses, peanuts, newspapers etc. on the roadside. We may also find cobbler repairing shoes on the footpath. Everyday you come across such type of shops in your locality. But have you ever tried to know how these businesses are run? Who are the owners of these businesses? What exactly does an owner do for any business? You may say, the owner invests capital to start the business, takes all decisions relating to business, looks after the day to day functioning of the business and finally, is responsible for the profit or loss. Yes, you are right. The owner does exactly all these things. If you go a bit further, you will find that in some businesses a single individual performs all these activities. This is called sole proprietorship. In some business group of individual join together to become owners of business and share the profits and losses. This is another form of business organization is known as partnership. Another form of business which is owned by the members of a Joint Hindu family and in which the family possesses some inherited property. It is known as Hindu Undivided Family Business.

In this lesson let us find out more about these types of business organisations.



### OBJECTIVES

After studying this lesson, you will be able to:

- explain the meaning of sole proprietorship form of business organisation;
- list the characteristics of sole proprietorship;
- describe the advantages and limitations of sole proprietorship;
- understand the meaning of partnership;

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## Sole Proprietorship, Partnership & Hindu Undivided Family

- identify the features of partnership form of business organisation;
- state the advantages and limitations of partnership form of business organisation;
- explain the concept of limited liability partnership; and
- explain Joint Hindu Family business with its characteristics, merits and limitations

### 3.1 MEANING OF SOLE PROPRIETORSHIP

‘Sole’ means single and ‘proprietorship’ means ownership. It means only one person or an individual is the owner of the business. Thus, the business organisation in which a single person owns, manages and controls all the activities of the business is known as sole proprietorship form of business organisation. The individual who owns and runs the sole proprietorship business is called a ‘sole proprietor’ or ‘sole trader’. A sole proprietor pools and organises the resources in a systematic way and controls the activities with the sole objective of earning profit.



Sole Proprietor

### 3.2 CHARACTERISTICS OF SOLE PROPRIETORSHIP

Sole proprietorship has the following characteristics :

- Ease of formation:**— An ideal form of ownership should be easy to form. Ease of formation implies minimum of legal and other formalities. Sole proprietorship is easy to form.
- Single Ownership :** A single individual always owns sole proprietorship form of business organization. That individual owns all assets and properties of the business. Hence, he alone bears all the risk of the business. Thus, the business of the sole proprietor comes to an end at the will of the owner or upon his death.
- No sharing of Profit and Loss :** The entire profit arising out of sole proprietorship business goes to the sole proprietor. If there is any loss it is also to be borne by the sole proprietor alone. Nobody else shares the profit and loss of the business with the sole proprietor.
- One man’s Capital :** The capital required by a sole proprietorship form of business organisation is totally arranged by the sole proprietor. He provides it either from his personal resources or by borrowing from friends, relatives, banks or other financial institutions.



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- v. **One-man Control :** The controlling power in a sole proprietorship business always remains with the owner. The owner or proprietor alone takes all the decisions to run the business.
- vi. **Unlimited Liability :** The liability of the sole proprietor is unlimited. This implies that, in case of loss the business assets along with the personal properties of the proprietor shall be used to pay the business liabilities.

### 3.3 ADVANTAGES OF SOLE PROPRIETORSHIP

The sole proprietorship form of business is the most simple and common in our country. It has the following advantages :

- i. **Easy to Form and Wind up :** A sole proprietorship form of business is very easy to form. With a very small amount of capital one can start the business. Legal formalities are minimum just like formation, it is also very easy to wind up the business. It is the owners, sole discretion to form or wind up the business at any time.
- ii. **Direct Motivation :** The profits earned belong to the sole proprietor alone and he bears the risk of losses as well. Thus, there is a direct link between effort and reward. If he works hard, then there is a possibility of getting more profit and vice versa This provides strong motivation for the sole proprietor to work hard.
- iii. **Quick Decision and Prompt Action :** In a sole proprietorship business the sole proprietor alone is responsible for all decisions. Since no one else is involved in decision making it becomes easy to take quick and prompt action on the basis of decision taken.
- iv. **Better Control :** In sole proprietorship business, the proprietor has full control over each and every activity of the business. He is the planner as well as the organiser, who co-ordinates every activity in an efficient manner. Since the proprietor has all authority with him, it is possible to exercise better control over business.
- v. **Maintenance of Business Secrets :** In the case of sole proprietorship business, the proprietor is in a very good position to keep his plans to himself since management and control are in his hands. There is no need to disclose any information to others.
- vi. **Close Personal Relation :** The sole proprietor is always in a position to maintain good personal contact with the customers and employees. Direct contact enables the sole proprietor to know the likes, dislikes and tastes of the customers. Also, it helps in maintaining close and friendly relations with the employees and thus, business runs smoothly.
- vii. **Provides Self-employment :** Sole proprietorship form of business organization provides self employment opportunities to the people. Not

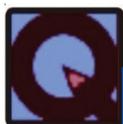


only is the owner self-employed, sometimes he also creates job opportunities for others. You must have observed in different shops that there are a number of employees assisting the owner in selling goods to the customers. Thus, it helps in reducing poverty and unemployment in the country.

### 3.4 LIMITATIONS OF SOLE PROPRIETORSHIP

One-man business is the best form of business organisation because of the above-discussed advantages. However, all types of ownership have some limitations and the sole proprietorship is no exception. Let us learn those limitations.

- i. Limited Capital :** In sole proprietorship business, it is the owner who arranges the capital required for the business. It is often difficult for a single individual to raise a huge amount of capital. The owner's own funds as well as borrowed funds sometimes become insufficient to meet the requirement of the business for its growth and expansion.
- ii. Lack of Continuity :** The existence of sole proprietorship depends on the owner. The business may come to an end as and when the sole proprietor so decides or in the event of his death.
- iii. Limited Size :** In sole proprietorship form of business organisation there is a limit beyond which it becomes difficult to expand its activities. It is not always possible for a single person to supervise and manage the affairs of the business if it grows beyond a certain limit.
- iv. Lack of Managerial Expertise :** A sole proprietor may not be an expert in every aspect of management. He/she may be an expert in administration, planning, etc., but may be poor in marketing.



#### INTEXT QUESTIONS 3.1

Fill in the blanks with suitable words in the following statements relating to sole proprietorship business :

- i. The sole proprietor may not be able to raise adequate \_\_\_\_\_ for the expansion of business.
- ii. The life of the business depends on the life of the \_\_\_\_\_ .
- iii. Due to limited financial resources and limitation of the expertise of the owner, the business may lack professional \_\_\_\_\_ .
- iv. The business is suitable for simple business where \_\_\_\_\_ skill is required.
- v. Sole proprietorship best caters the needs of customers where the market for the product is \_\_\_\_\_ and \_\_\_\_\_ .



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### 3.5 MEANING OF PARTNERSHIP

You have studied that sole proprietorship form of business organisation has certain limitations. Its financial and managerial resources are limited. It is also not possible to expand the business activities beyond a certain limit. In order to overcome these drawbacks, another form, i.e., partnership form of business has come into existence. Let us first find out what is 'partnership'



Picture of a Partnership

Suppose you want to open a restaurant in your locality. You will need to gather a lot of things. You may find that it is not possible to arrange the money required to start and run the business alone. You may then talk to your friends and all of you agree to run the restaurant by contributing a certain amount of money and the other things required. So all of you join hands together to become the owners and share the profits and losses. This is another form of business organization, which may be known as partnership.

It is basically a relation between two or more persons who join hands to form a business organisation with the objective of earning profit. The persons who join hands are individually known as 'Partner' and collectively a 'Firm'. The name under which the business is carried on is called 'firm name'. Sultan Chand & Co. Ram Lal & Co. Gutpa & Co. are the names of some partnership firms.

A partnership firm is governed by the provisions of the Indian Partnership Act, 1932. Section 4 of the Indian Partnership Act, 1932, defines partnership as "a relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all".

### 3.6 CHARACTERISTICS OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

After having a brief idea about partnership, let us identify the various features of this form of business organisation.

- i. **Two or more Members** – At least two members are required to start a partnership business. But the number of members should not exceed 10 in case of banking business and 20 in case of other business.
- ii. **Agreement** : Whenever you think of joining hands with others to start a partnership business, first of all, there must be an agreement between all of you. This agreement contains -



- the amount of capital contributed by each partner,
  - profit or loss sharing ratio;
  - salary or commission payable to the partners, if any;
  - duration of business, if any;
  - name and address of the partners and the firm;
  - duties and powers of each partner;
  - nature and place of business; and
  - any other terms and conditions to run the business.
- iii. Lawful Business** – The partners should always join hands to carry on any kind of lawful business. To indulge in smuggling, black marketing etc, can not be called partnership business in the eye of the law.
- iv. Sharing of Profit** – The main objective of every partnership firm is sharing of profits of the business amongst the partners in the agreed proportion. In the absence of any agreement for the profit sharing, it should be shared equally among the partners.
- v. Unlimited Liability**– Just like the sole proprietor the liability of partners is also unlimited. That means, if the assets of the firm are insufficient to meet the liabilities, the personal properties of the partners, if any, can also be utilised to meet the firm’s liabilities.
- vi. Voluntary Registration** – It is not compulsory that you register your partnership firm. However, if you don’t get your firm registered, you will be deprived of certain benefits, therefore, it is desirable. The effects of non-registration are :
- Your firm cannot take any action in a court of law against any other party for settlement of claims.
  - In case there is any dispute among partners, it is not possible to settle the settlement of claims, through a court of law.
  - Your firm cannot claim adjustments for amount payable to or receivable from any other party through a Court of law.
- vii. Principal Agent Relationship**– All the partners of a firm are the joint owners of the business. They all have an equal right to actively participate in its management. Every partner has a right to act on behalf of the firm. When a partner deals with other parties in business transactions, he/she acts as an agent of the others and at the same time the others become the principal. So there always exists a principal agent relationship in every partnership firm.
- viii. Continuity of Business** – A partnership firm comes to an end in the event of death, lunacy or bankruptcy of any partner. Even otherwise, it can discontinue its business at the will of the partners. At any time, they may take a decision to end their relationship.



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### 3.7 ADVANTAGES OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

Partnership form of business organisation has certain advantages, which are as follows:

- i. **Easy to form** – Like sole proprietorship, the partnership business can be formed easily without any legal formalities. It is not necessary to get the firm registered. A simple agreement, either oral or in writing, is sufficient to create a partnership firm.
- ii. **Availability of large resources** – Since two or more partners join hands to start partnership business it may be possible to pool more resources as compared to sole proprietorship. The partners can contribute more resources as compared to sole proprietorship. The partners can contribute more capital, more efforts and also more time for the business.
- iii. **Balanced decisions** – The partners are the owners of the business. Each of them has equal right to participate in the management of the business. In case of any conflict they can sit together to solve the problems. Since all partners participate in decision-making, there is less scope for reckless and hasty decisions.
- iv. **Sharing of losses** – In a partnership firm all the partners share the business risks. For example, if there are three partners and the firm suffers a loss of Rs. 12,000 during a particular period, then all partners may share it and the individual burden will be Rs. 4,000 only.

### 3.8 LIMITATIONS OF PARTNERSHIP FORM OF BUSINESS ORGANISATION

In spite of all these advantages as discussed above, a partnership firm also suffers from certain limitations, some of them are as follows :

- i. **Unlimited Liability** – All the partners are jointly as well as individually liable for the debts of the firm to an unlimited extent. Thus, they can share the liability among themselves or any one can be asked to pay all the debts even from his personal properties.
- ii. **Uncertain Life** – The partnership firm has no legal entity separate from its partners. It comes to an end with the death, insolvency, incapacity or the retirement of any partner. Further, any dissenting member can also give notice at any time for dissolution of partnership.
- iii. **Limited Capital** – Since the total number of partners cannot exceed 20, the capital to be raised is always limited. It may not be possible to start a very large business in partnership form.
- iv. **Non transferability of share** – If you are a partner in a firm you cannot transfer your share of interest to outsiders without the consent of other



partners. This creates inconvenience for the partner who wants to leave the firm or sell part of his share to others.

### **3.9 LIMITED LIABILITY PARTNERSHIP**

A corporate business vehicle that enables professional expertise and entrepreneurial initiative to combine and operate in flexible, innovative and efficient manner, providing benefits of limited liability while allowing its members the flexibility for organizing their internal structure as a partnership is called LLP.

1. With the growth of the Indian economy, the role played by its entrepreneurs as well as its technical and professional manpower has been acknowledged internationally. It is felt opportune that entrepreneurship, knowledge and risk capital combine to provide a further impetus to India's economic growth. In this background, a need has been felt for a new corporate form that would provide an alternative to the traditional partnership, with unlimited personal liability on the one hand, and, the statute-based governance structure of the limited liability company on the other, in order to enable professional expertise and entrepreneurial initiative to combine, organize and operate in flexible, innovative and efficient manner.
2. The limited Liability Partnership (LLP) is viewed as an alternative corporate business vehicle that provides the benefits of limited liability but allows its members the flexibility of organizing their internal structure as a partnership based on a mutually arrived agreement. The LLP form would enable entrepreneurs, professionals and enterprises providing services of any kind or engaged in scientific and technical disciplines, to form commercially efficient vehicles suited to their requirements. Owing to flexibility in its structure and operation, the LLP would also be a suitable vehicle for small enterprises and for investment by venture capital.
3. Keeping in mind the need for the day, the Parliament enacted the Limited Liability Partnership Act, 2008 which received the assent of the President on 7<sup>th</sup> January, 2009.

**The salient features of the LLP Act 2008 inter alia are as follows :**

- (i) The LLP shall be a body corporate and a legal entity separate from its partners. Any two or more persons, associated for carrying on a lawful business with a view to profit, may by subscribing their names to an incorporation document and filing the same with the Register, form a Limited Liability Partnership. The LLP will have perpetual succession;



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- (ii) The mutual rights and duties of partners of an LLP inter se and those of the LLP and its partners shall be governed by an agreement between the LLP and the partners subject to the provisions of the LLP Act 2008. The act provides flexibility to devise the agreement as per their choice. In the absence of any such agreement, the mutual rights and duties shall be governed by the provisions of the LLP Act.
- (iii) The LLP will be a separate legal entity, liable to the full extent of its assets, with the liability of the partners being limited to their agreed contribution in the LLP which may be of tangible or intangible nature or both tangible and intangible in nature. No partner would be liable on account of the independent or un-authorized actions of other partners of their misconduct. The liabilities of the LLP and partners who are found to have acted with intent to defraud creditors or for any fraudulent purpose shall be unlimited for all or any of the debts or other liabilities of the LLP;
- (iv) Every LLP shall have at least two partners and shall also have at least two individuals as Designated Partners, of whom at least one shall be resident in India. The duties and obligations of Designated Partners shall be as provided in the law;



### **INTEXT QUESTIONS 3.2**

Fill in the blanks with appropriate word given in bracket.

- i. It is \_\_\_\_\_ (not necessary, necessary) to get the partnership firm registered.
- ii. The partnership firm is a \_\_\_\_\_(flexible, rigid) form of business organization.
- iii. In partnership, business risk is \_\_\_\_\_ (shared, not shared) by all the partners.
- iv. Partnership is a/an \_\_\_\_\_ (group, individual) effort.
- v. LLP act was framed in the year\_\_\_\_\_. (2008, 2010)

### **3.10 MEANING OF JOINT HINDU FAMILY BUSINESS**

The Joint Hindu family business refers to a business which is owned by the members of a joint Hindu family. It is also known as Hindu Undivided Family Business. This form of organisation exists under Hindu law and is governed by the law of succession. The joint Hindu family form is a form of business organisation in which the family possesses some inherited property. The inheritance of the property is among the male members. The share of ancestral

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property is inherited by a member from his father, grandfather and great grandfather. Thus, three successive generations can simultaneously inherit the ancestral property. For purposes of running of joint Hindu family business, only male members are entitled who are referred to as coparceners. The oldest member is known as the *Karta*.



Picture of a Joint Hindu Family

### 3.11 FEATURES OF THE JOINT HINDU FAMILY BUSINESS

- i. **Membership by birth :** Membership of a Joint Hindu family business is automatic by birth of a male child. It is not created by an agreement among family members.
- ii. **Management :** The management vests in the *Karta*, the eldest member of the family. However, the *Karta* may associate other members of the HUF to assist him.
- iii. **Liability :** The *Karta* has unlimited liability, i.e. even his personal assets can be used for payment of business dues. Every other coparcener has a limited liability upto his share in the HUF property.
- iv. **No Maximum limit :** There is no restriction on the number of coparceners of the HUF business. However, the membership is restricted to three successive generations.
- v. **Minor members :** A male child at the time of birth becomes a coparcener. Thus, an HUF does not restrict membership to minors.
- vi. **Unaffected by death :** The HUF business continues even after the death of a coparcener including the *Karta*. The next senior most surviving male member of the HUF becomes the *Karta*. However, it may come to an end if all the members notify that they are not members of the Joint Hindu Family.

### 3.12 MERIT OF JOINT HINDU FAMILY BUSINESS

- i. **Economic security and status to the members :** The Joint Hindu Family business provides members a sense of security and belonging because of the financial stake they possess in it. It also gives them status in society while dealing with others.
- ii. **Continuity of business :** The business has a continuity. It is not affected by death or lunacy of members, including the *Karta*. Till such time that the members jointly do not decide to terminate it, the business continuous to exist.



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- iii. **Family pride :** Members are likely to work with dedication, loyalty and care, because the work involves the family name. The business is not only an economic unit but also a matter of family prestige.

### 3.13 LIMITATIONS OF JOINT HINDU FAMILY BUSINESS

- i. **Unlimited liability :** The *Karta* is personally liable for all business obligations. For payment of business debts, his personal property can be sold if the business assets are insufficient.
- ii. **Limited access to capital :** The *Karta* has limited scope for raising capital. Her/his own funds may be insufficient for expansion. This reduces the scope for business growth.
- iii. **Karta too powerful :** An incompetent *Karta* may ruin the business since all business decisions are taken by him.
- iv. This form of business organisation is perhaps the natural economic extension of the joint Hindu family. It serves to provide economic security and status to members. It continues to have an important place in Indian business.



### INTEXT QUESTIONS 3.3

- I. Fill in the blanks by choosing a suitable word(s) :
- (i) HUF stands for \_\_\_\_\_
- (ii) \_\_\_\_\_ successive generations can simultaneously inherit the ancestral property.
- (iii) Members of Joint Hindu Undivided family are known as \_\_\_\_\_
- (iv) Oldest member of the Joint Hindu Undivided family is known as \_\_\_\_\_
- (v) \_\_\_\_\_ has unlimited liability.
- II. Multiple Choice Questions
- i. Himanshi is running a business in sole-proprietorship. Due to loss in business she decided to wind up her business. On the day of winding up the assets are worth Rs. 5 lakhs and liabilities (all creditors) are worth Rs. 10 lakhs. Himanshi has her personal property of Rs. 600000. How much do you think the creditors will get at the time of winding up of business?
- (a) Rs. 5 Lakhs (b) Rs. 10 lakhs  
(c) Rs. 7 lakhs (d) Rs. 11 lakhs.

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- ii. Limitations of sole Proprietorship do not include.  
(a) Limited Capital (b) Lack of Continuity  
(c) Unlimited size (d) Lack of Managerial Expertise.
- iii. Indian Partnership Firms are governed by Indian Partnership act  
(a) 1932 (b) 1956  
(c) 2008 (d) 1912
- iv. Characteristics of JHF do not include  
(a) Membership by birth (b) Unlimited Liability of Karta  
(c) Unaffected by death (d) Youngest Member of family is Karta.
- v. Members of Joint Hindu Family are known as:  
(a) Partners (b) Members  
(c) Coparceners (d) Owners



### WHAT YOU HAVE LEARNT

- Sole Proprietorship is a form of business organization in which a single person owns, manages and controls the business enterprise with all authority, responsibility and risk.
- In sole proprietorship business there is single ownership. The sole proprietor controls the business and his/her liability is unlimited. The proprietor bears the profit or loss and invests the capital from own sources. He/she may borrow it from friends and relatives or may take loan from banks and other financial institutions. Starting and operating the business does not requires any legal formalities.
- Sole proprietorship business is easy to form and wind up. In this business, decisions are taken quickly, better control can be exercised over the business activities and secrecy can be maintained
- Partnership is the relation between two or more persons who have agreed to share the profits of a business carried on by all or any of them acting for all.
- LLP provides the benefits of limited liability but allows its members the flexibility of organizing their internal structure as partnership based on mutually arrived agreement.
- The persons who join hands are individually known as 'Partner' and collectively a 'Firm'. The name under which the business is carried on is called 'Firm name'.
- The Joint Hindu Family business refer to business which is owned by the members of Joint Hindu Family.



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- For purpose of running of Joint Hindu Family business, only male members are entitled who are referred to as Co-Parcener.
- The oldest member of the family is known as the Karta.



### TERMINAL EXERCISE

1. Define 'Sole proprietorship'.
2. What is meant by Sole Proprietorship form of business organisation ?
3. Can a sole proprietorship business exist forever ? Justify your answer.
4. Describe how sole proprietorship facilitates employment generation ?
5. State the maximum number of partners in case of banking and other business?
6. Define Partnership?
7. State any four features of a partnership form of business organization?
8. Define Joint Hindu Family?
9. State characteristics of Joint Hindu Family?
10. Write down the silent features of LLP.



### ANSWER TO INTEXT QUESTIONS

- 3.1** (i) Capital , (ii) Proprietor/owner, (iii) Management,  
(iv) Manual, (v) Small, local
- 3.2** (i) not necessary, (ii) flexible, (iii) shared,  
(iv) group, (v) 2008
- 3.3** I. (i) Hindu Undivided Family, (ii) Three, (iii) Coparcener,  
(iv) Karta (v) Karta
- II. (i) b, (ii) c, (iii) a, (iv) d, (v) c

### ACTIVITY FOR YOU

- Survey various businesses around you and find out whether they are sole traders, partnership or joint Hindu family business. Also note the characteristics by which they differ from each other.