



## **FORMS OF BUSINESS ORGANISATION**

### **3.0 INTRODUCTION**

After identifying the business in any field e.g., Insurance, it is necessary then to have a legal entity to be known in the society. The legal entity can be in any form of a business organization. The various forms of organization are as follows:

- 1) Sole proprietorship
- 2) Partnership
- 3) Co-operative Society
- 4) Joint stock company (Private and Public)

These are explained in brief as follows:-

### **3.1 OBJECTIVES**

At the end of this lesson you will be able to know

- Various forms of organization
- Its formation & features
- Merits & Demerits

### **3.2 SOLE PROPRIETORSHIP**

#### **3.2.1 Meaning:**

The sole proprietorship is a form of business that is owned, managed and controlled by an individual. He has to arrange capital for the business and he alone is responsible for its management. He is therefore, entitled to the profits and has

to bear the loss of business, however, he can take the help of his family members and also make use of the services of others such as a manager and other employees.

This type of business organisation is also called single ownership or single proprietorship. If the business primarily consists of trade, the organization is a sole trading organization. Small factories and shops are often found to be sole proprietorship organisations.

It is the simplest and most easily formed business organization. This is because not much legal formality is required to establish it. For instance to start a factory the permission of the local authorities is sufficient. Similarly to start a restaurant, it is only necessary to get the permission of local health authorities. Or again, to run a grocery store, the proprietor has only to follow the rules laid down by local administration.

### 3.3.2 Features of Sole Proprietorship:

The important features of a sole-proprietary organization include the following:

- (i) **Individual Initiative:** One person is the owner in a sole-proprietary form of organisation.
- (ii) **Risk Bearing:** The proprietor is the sole beneficiary of profits in this form organisation. If there is a loss he alone has to bear it. Thus the risks of business are borne by the proprietor himself.
- (iii) **Management and control:** Management and control of this type of organisation is the responsibility of the sole proprietor. He may, however, employ a manager or other people for the purpose.
- (iv) **Minimum government regulations:** The government does not interfere with the working of the sole proprietorship organisation. However, they have to comply with the general laws and rules laid down *by* government.
- (v) **Unlimited liability:** The sole proprietor has to bear the losses and is responsible for the liabilities of the business. If the business assets are not sufficient to meet the liabilities, he may also have to sell his personal property for that purpose.
- (vi) **Secrecy:** All important decision taken by the owner himself. He keeps all the business secrets only to himself.



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**Notes****3.3.3 Merits Of Sole Proprietorship:**

A sole proprietary organisation has the following advantages:

- (i) **Easy formation:** A sole proprietorship business is easy to form where no legal formality involved in setting up this type of organization. It is not governed by any specific law. It is simply required that the business activity should be lawful and should comply with the rules and regulations laid down by local authorities.
- (ii) **Better Control:** In sole proprietary organisation, all the decisions relating to business operations are taken by one person, which makes functioning of business simple and easy. The sole proprietor can also bring about changes in the size and nature of activity. This gives better control to business.
- (iii) **Sole beneficiary of profits:** The sole proprietor is the only person to whom the profits belong. There is a direct relation between effort and reward. This motivates him to work hard and bear the risks of business.
- (iv) **Benefits of small-scale operations:** The sole proprietorship is generally organized for small-scale business. This helps the proprietor's family members to be employed in business. At the same time such a business is also entitled to certain concessions from the government. For example, small industrial organisations can get electricity and water supply at concessional rates on a priority basis.
- (v) **Inexpensive Management:** The sole proprietor does not appoint any specialists for various functions. He personally supervises various activities and can avoid wastage in the business.

**3.3.4 Limitations Of Sole Proprietorship:**

A sole proprietor generally suffers from the following limitations:

- (i) **Limitation of management skills:** A sole proprietor may not be able to manage the business efficiently as he is not likely to have necessary skills regarding all aspects of the business. This poses difficulties in the growth of business also.

- (ii) **Limitation of Resources:** The sole proprietor of a business is generally at a disadvantage in raising sufficient capital. His own capital may be limited and his personal assets may also be insufficient for raising loans against their security. This reduces the scope of business growth.
- (iii) **Unlimited liability:** The sole proprietor is personally liable for all business obligations. For payment of business debts, his personal property can also be used if the business assets are insufficient.
- (iv) **Lack of continuity:** A sole proprietary organisation suffers from lack of continuity. If the proprietor is ill this may cause temporary closure of business. And if he dies the business may be permanently closed.

From the above account of the merits and limitations it becomes clear that it is only personal services like repair work, tailoring etc. small factories, retail shops and professional activities which can be set up as sole proprietary organisations. In India, this form of organisation is quite popular and accounts for the largest number of business units.

### 3.3 PARTNERSHIP

#### Meaning

Partnership is an association of persons who agree to combine their financial resources and managerial abilities to run a business and share profits in an agreed ratio. Since the resources of a sole proprietor to finance, and his capacity to manage a growing business is limited, he feels the need for a partnership firm. Partnership business, therefore, usually grows out of the need for expansion of business with more capital, better supervision and control, division of work and spreading of risks.

The Indian Partnership Act defines partnership as “Partnership” is the relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all. The persons who have agreed to join in partnership are individually called “Partners” and collectively a ‘firm’. A partnership firm can be formed with a minimum of two partners and it can have a maximum of twenty partners.



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**3.3.1 Features of Partnership:**

The features of partnership are as follows:

- (i) **Existence of an agreement:** Partnership is formed on the basis of an agreement between two or more persons to carry on business. It does not arise out of the operation of law as in the case of joint Hindu family business. The terms and conditions of partnership are laid down in a document known as Partnership Deed.
- (ii) **Engagement in business:** A partnership can be formed only on the basis of a business activity. Its business may include any trade, industry or profession. Thus, a partnership can engage in any occupation - production and/or distribution of goods and services with a view to earning profits.
- (iii) **Sharing of profits and losses:** In a partnership firm, partners are entitled to share in the profits and are also to bear the losses, if any.
- (iv) **Agency relationship:** The partnership business may be carried on by all or any of the partners acting for all. Thus, each partner is a principal and so can act in his own right. At the same time he can act on behalf of other partners as their agent. Thus, every partner can bind the firm by his acts.
- (v) **Unlimited Liability:** The liability of partners is unlimited as in the case of sole proprietorship. In case some obligation arises then not only the partnership assets but also the private property of the partners can be taken for the payment of liabilities of the firm.
- (vi) **Common Management:** Every partner has a right to take part in the running of the business. It is not necessary for all partners to participate in the day-to-day activities of the business but they are entitled to participate. Even if partnership business is run by some partners, the consent of all other partners is necessary for taking important decisions.
- (vii) **Restriction on transferability of share:** No partner can transfer his share in partnership to any other person. He may, however, do so with the consent of all other partners.

**(viii) Registration:** To form a partnership firm, it is not compulsory to register it. However, if the partners so decide, it may be registered with the Registrar of Firms. There are advantages of registration, which are discussed later.

**(ix) Duration:** The partnership firm continues at the pleasure of the partners. Legally a partnership comes to an end if any partner dies, retires or becomes insolvent. However, if the remaining partners agree to work together under the original firm's name, the firm will not be dissolved and will continue its business after settling the claim of the outgoing partner.

### **3.3.2 Formation and Registration:**

#### **Partnership Deed:**

Since partnership rests on an agreement among persons, its formation does not involve any special legal problems. Generally, the partnership agreement is reduced to writing and a Partnership Deed is prepared. Partnership Deed lays down the terms and conditions of partnership and the rights, duties and obligations of partners. The following points are generally covered in the Deed:

- (i) The nature of business.
- (ii) Name of the firm and the place where its business will be carried on.
- (iii) Amount of capital to be contributed by each partner.
- (iv) Duties, powers and obligations of all the partners.
- (v) Method of preparing accounts and arrangement for audit.
- (vi) Whether loans will be accepted from a partner over and above the capital also, if so, at what rate of interest.
- (vii) The amount to be allowed as private drawings by each partner and the interest to be charged thereon.
- (viii) The ratio in which profits are to be shared.
- (ix) Whether a partner can be expelled and, if so, the procedure for the same.
- (x) Method for the settlement of disputes.

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- (xi) Circumstances under which the partnership will stand dissolved, and in case of dissolution, under whose custody the books of accounts will remain.

The Deed has to be stamped and each partner should have a copy of it.

**3.3.3 Registration of firm:**

Registration of a partnership firm is not compulsory under Indian Partnership Act. In England registration is compulsory. In India, certain privileges which are allowed to those firms, which are registered. But an unregistered firm suffers from certain disabilities. These disabilities make it virtually compulsory for a firm to get registered. A partnership firm may be registered at any time. That is, at the time of formation or at any time during its existence. A partnership firm desiring registration applies to the Registrar of Firms in prescribed form along with the registration fee. The application should state the following:

- (i) Name of the firm.
- (ii) The principal place of business of the firm.
- (iii) The name of any other place where the firm is to carry on business:
- (iv) Date of admission of the partners in the firm.
- (v) Names and permanent addresses of the partners.
- (vi) Duration of the firm.

The application shall be signed and verified by each partner. Changes in the above particulars have to be communicated to the Registrar. The Certificate of registration is reliable evidence and a conclusive proof of the existence of the firm.

**3.3.4 Consequences of Non-Registration:**

An unregistered firm suffers from the following serious disabilities:

- (i) A partner of an unregistered firm can not file a suit against the firm or any other partner for enforcing his right arising out of the contract;
- (ii) An unregistered firm cannot file suit against any third party for the recovery of the claims;
- (iii) Such a firm also cannot file a suit against any partner.

### 3.3.5 Types of Partnership

According to the nature of agreement among partners, there can be three types of partnership as follows:

- (i) **Partnership at-will:** Such a partnership exists on the will of the partners. That is, it can be brought to an end whenever any partner gives notice of his intention to do so.
- (ii) **Particular partnership:** A particular partnership is formed for undertaking a particular venture. It comes to an end automatically with completion of the venture.
- (iii) **Partnership for a fixed duration:** Such partnership is for a fixed period of time say 2 years, 5 years or any other duration.

### 3.3.6 Types of Partners

The various types of partner found in partnership firms are as follows:

- (i) **Active Partners:** Partners who take active part in the conduct of day-to-day business of the firm are called active partners. These partners carry on business on behalf of the other partners.
- (ii) **Sleeping or dormant partners:** Sleeping or dormant partners are those who do not take active part in the management of the business. Such partners only contribute capital in the firm and are bound by the activities of other partners. However, they share in the profits and losses of the business.
- (iii) **Others:** Active and sleeping partners are, as a matter of fact, the full-fledged partners i.e. they share in profits and losses of the business and are liable for its dues. However, there are other types of partners also who may be associated with partnership directly or indirectly. They are not full-fledged partners, such partners may include the following:
  - (a) **Nominal Partners:** Nominal partners are those who do not have interest in the business but lend their name to the firm. They do not make any capital contribution, and are not entitled to take part in management, but are liable, like other partners, to



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third parties. Such partners generally have a pecuniary interest (like a share in the profits) in lending their name to a firm. However in certain cases they may not have any pecuniary interest in doing so. For example, a reputed industrialist may, without any profit motive lend his name to a firm run by his family members.

- (b) Partners by holding out:** If a person by his words or conduct holds out to another that he is a partner, he will be prevented from denying that he is not a partner. The person who thus becomes liable to third parties to pay the debts of the firm is known as a partner by holding out.

### 3.3.7 Minor admitted into the benefits of partnership

A minor is a person who has not attained the age of 18 years. Since a minor is not capable of entering into a valid agreement, he cannot become partner of a firm. He may, however, be admitted to the benefits of an existing partnership.

It is clear from the preceding discussion that partners can be of three categories:

- (i) Those who share in the profits and losses of the business and assume liability of the business debts (like active partners, dormant partners and nominal partners).
- (ii) Those who share in profits only (like minor partners) and
- (iii) Those who assume liability without sharing in the profits of the business (like partners by holding out).

### 3.4.8 Merits of Partnership

A partnership form of organisation offers the following advantages:

- (i) Ease in formation:** A partnership is very easy to form. All that is required is an agreement among the partners. Even the expenses to be incurred for registration are not much.
- (ii) Pooling of financial resources:** A partnership commands more financial resources compared to sole proprietorship. This helps in expanding business and earning more profits. As and when a firm requires more money, more partners can be admitted.

- (iii) Pooling of managerial stalls:** A partnership facilitates pooling of managerial skills of all its partners. This leads to greater efficiency in business operations. For instance, in a big partnership firm, one partner can handle production function, another partner can look after all marketing activity, still another can attend to legal and personnel problems, and so on.
- (iv) Balanced business decisions:** In a partnership firm, decisions are taken unanimously after considering all the major aspects of a problem. This ensures not only balanced business decisions but also removes difficulties in the smooth implementation of those decisions.
- (v) Sharing of risks:** Unlike sole proprietary organisation, the risks of partnership business are shared by partners on a predetermined basis. This encourages partners to undertake risky but profitable business activities.

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### 3.3.9 Limitations of Partnership

A partnership form of organisation suffers from the following major limitations:

- (i) Uncertainty of existence:** The existence of a partnership firm is very uncertain. The retirement, death, bankruptcy or lunacy of any partner can put an end to the partnership. Further, the partnership business can come to a close if any partner demands it.
- (ii) Risks of implied authority:** It is true that like the sole proprietor each partner has unlimited liability. But his liability may arise not only from his own acts but also from the acts and mistakes of co-partners over whom he has no control. This discourages many persons with money and ability, to join a partnership firm as partner.
- (iii) Risks of disharmony:** In partnership, since decisions are taken unanimously, it is essential that all partners reconcile their views for the common good of the organisation. But there may arise situations when some partners may adopt rigid attitudes and make it impossible to arrive at a commonly agreed decision. Lack of harmony may paralyse the business and cause conflict and mutual bickering.
- (iv) Difficulty in withdrawal from the firm:** Investment in a partnership can be easily made but cannot be easily



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withdrawn. This is so because the withdrawal of a partner's share requires the consent of all other partners.

- (v) **Lack of institutional confidence:** A partnership business does not enjoy much confidence of banks and financial institutions. It is because the nature of its activities is not disclosed at public and the agreement among partners is not regulated by any law. As a result large financial resources cannot be raised by partnership and growth of business cannot be ensured.
- (vi) **Difficulties of expansion:** It is difficult for a partnership firm to undertake modernization of expansion of its operations. This is because of its inability to raise adequate funds for the purpose. Limited membership (restricted to 20) and their limited personal resources do not permit large amounts of capital to be raised by the partners. Therefore, large-scale business cannot generally be organised by partnerships.

It is quite obvious from the discussions that the partnership form of organisation is excellent when the size of business is medium, i.e. neither too small not too large, and when the partners can work in full co-operation with one another,

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**INTEXT QUESTIONS 3.1**


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1. Whether the liability of sole proprietorship is limited or unlimited?
  2. How many minimum members are required to form partnership firm?
  3. Is it compulsory to register the partnership firm?
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**3.4 CO-OPERATIVE ORGANISATION**
**3.4.1 Meaning:**

A co-operative form of business organization is different from other forms of organization. It is a voluntary association of persons for mutual benefit and its aims are accomplished through self help and collective effort. The main principle underlying a cooperative organization is mutual help, i.e., each for one and all for each. A minimum of 10 persons are required to form a co-operative society. To be called a co-operative society

it must be registered with the Registrar of Co-operative Societies under the Co-operative Societies Act. The capital of a co-operative Society is raised from its members by way of share capital. It can also obtain additional resources by way of loans from the State and Central Co-operative Banks.

A Co-operative society has much in common with partnership, yet there are differences between the two types of organisation. In partnership, mutual benefit is restricted to partners only, but in a co-operative society it extends to its members as also the public. For example in a consumer co-operative store or a co-operative credit society, the benefits are available to the members as well as the general public. Besides, partnership requires the existence of some business activity whereas a co-operative may be formed whenever individuals have common needs, which are difficult to fulfill single-handed. Also, registration is optional in the case of partnership but it is compulsory for a co-operative society.

### 3.4.2 Type of Co-operative Societies

Co-operative societies may be classified into different categories according to the nature of activities performed by them. The main types of co-operative societies are:

1. Consumers' co-operative societies.
  2. Producers' co-operative societies.
  3. Co-operative marketing societies.
  4. Co-operative credit societies.
  5. Co-operative farming societies.
  6. Co-operative housing societies.
- 1. Consumers' co-operative societies:** Consumer' co-operatives are organised by consumers to eliminate middlemen and to establish direct relations with the manufacturers or wholesalers. These societies are formed by consumers to ensure a steady supply of goods and services of high quality at reasonable prices. It purchases goods either from the manufacturers or wholesalers for sale at reasonable prices. The profit if any, is distributed among members as dividend in the ratio of capital contributed and also bonus in proportion to the purchases made by them.



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- 2. Producers' co-operative societies:** Producers' co-operative are formed to help the members in procuring inputs for production of goods or services. These societies generally provide raw material, tools and equipment and other common facilities to its members. This helps them to concentrate their attention on production of goods. The society provides inputs to the members and takes over their output for sale to outsiders. The basis for distribution of bonus is the goods delivered for sale by each member.
- 3. Co-operative marketing societies:** Co-operative marketing societies are voluntary associations of small producers, who find it difficult to individually sell their products at a profit. The main purpose of such a society is to ensure a steady and favourable market for the output of its members. The output is pooled together and sold at the best price. The sale proceeds are distributed in proportion to the contribution of the members to the pool. Marketing co-operatives eliminate middlemen and ensure honest trading practices in weighing, measuring and accounting.
- 4. Co-operative credit societies:** Such societies are formed to provide financial help in the form of loans to members. The funds of these societies consist of share capital contributed by the members and the deposits made by them and outsiders. The funds are used in giving loans to needy members on easy terms. Thus, the members are protected from the exploitation of moneylenders, who charge very high rates of interest. Another important purpose of credit co-operatives is to encourage the habit of thrift among their members.
- 5. Co-operative farming societies:** In co-operative farming societies, small farmers join together and pool their resources for cultivating their land collectively. Their objective is to achieve economies of large scale farming and maximising agricultural output. Such societies are particularly important in the case of countries like India, where agriculture suffers from excessive sub-division and fragmentation of land. Co-operative farming makes it possible for members to use modern tools and equipments, good seeds, fertilizer and irrigation facilities in order to achieve higher production.

- 6. Co-operative housing societies:** They are formed to provide residential accommodation to the members. They undertake the purchase and development of land and/or construction of houses/flats on the land. Some housing co-operatives provide their members with necessary loans at low rates of interest to build houses. These societies are gaining popularity in big cities.

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### 3.4.3 Characteristics of Co-operative Organisation

The following are the main characteristics of cooperative societies:

- (i) Voluntary association:** In co-operatives, the membership is voluntary. Anybody having a common interest is free to join a co-operative society. The member can also leave the society anytime after giving proper notice.
- (ii) Equal voting rights:** In a co-operative society, the principle of one-man one vote is adopted. A member has only one vote irrespective of the number of share(s) held by him. Thus, a co-operative society is run on democratic principles.
- (iii) Separate legal entity:** A co-operative society is required to be registered under the Co-operative Societies Act. Registration provides it a separate legal entity. Its existence is quite different from its members. The death, insolvency or lunacy of a member does not affect its existence. It can sue and be sued in its own name. It can make agreements as well as purchase and sell properly in its own name.
- (iv) Service motive:** A co-operative society is based on the service motive of its members. It's main objective is to provide service to the members and not to maximize profits. Earning profit is the most important objective of other forms of business organisation. It is not so in the case of co-operatives.
- (v) Distribution of surplus:** Out of the profits of the co-operative, members are paid dividend and bonus. The bonus is given according to the volume of business transacted by each member with the co-operative society. For example, in a consumer co-operative society, bonus is paid in proportion to the purchases made by members during a year. In producers' co-operative the valued goods delivered for sale form the basis of distributing bonus.

**Notes****3.4.4 Merits of Co-operative Organisations**

The co-operative form of organisation offers the following advantages:

- (i) **Easy to form:** A co-operative society is voluntary association and may be formed with a minimum of ten adult members. Its registration is very simple and can be done without much legal formalities.
- (ii) **Open membership:** Membership in a Co-operative organisation is open to all having a common interest . A person can become a member at any time he likes and can leave the society by returning his shares without affecting its continuity.
- (iii) **Democratic management :** A co-operative society is managed in a democratic manner. It is based on principle of one man one vote. All members have equal rights and can have a voice in its management.
- (iv) **Limited liability:** The liability of the members of a co-operative society is limited to the extent of capital contributed by them. They don't have to bear personal liability for the debts of the society.
- (v) **Stability:** A co-operative society has a separate legal existence. It is not affected by the death, insolvency, lunacy or permanent incapacity of any of its members. It has a fairly stable life and continues to exist for a long period.
- (vi) **Economical operations:** The operation of co-operative society is quite economical due to elimination of middlemen and the voluntarily services provided by its members.
- (vii) **Government patronage:** Government gives all kind of help to co-operatives, such as loans at lower rates of interest and relief in taxation.
- (viii) **Other benefits:** Certain non-economic benefits are also derived by members through cooperatives. Credit co-operatives, for instance, promote habits of thrift and producers' co-operative encourage joint activity among members.

### 3.4.5 Limitations of Co-operative Organisations

As against the above-mentioned advantages of cooperatives the following limitations and drawbacks of this form of organisation must also be noted:

- (i) **Limited capital:** Co-operatives are usually at a disadvantage in raising capital because of the low rate of return on capital invested by members.
- (ii) **Inefficient management:** The management of a co-operative society is generally inefficient because the managing committee consists of part-time and inexperienced people. Qualified managers are not attracted towards a co-operative on account of its limited capacity to pay adequate remuneration.
- (iii) **Absence of motivation:** A co-operative society is formed for mutual benefit and the interest of individual members are not fully satisfied. There is no direct link between effort and reward. Hence members are not inclined to put in their best efforts in a co-operative society.
- (iv) **Differences and factionalism among members:** Once the initial enthusiasm about the co-operative ideal is exhausted, differences and group conflicts arise among members. Then it becomes very difficult to get full co-operation of the members. The selfish motives of members begin to dominate and service motive is some times forgotten. But the society continues because it functions in the interest of members.
- (v) **Rigid rules and regulations:** Excessive government regulation and control over Co-operatives affect their functioning. For example, a Co-operative society is required to get its accounts audited by the auditors of the co-operative department and submit its accounts regularly to the Registrar. These regulations and control may adversely affect the flexibility of operations and the efficiency of management in a co-operative society.

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#### INTEXT QUESTION 3.2

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1. What is the main aim of co-operative society?
  2. What are the voting rights of the members in a co-operative society?
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**Notes****3.5 COMPANY**

The company form of organisation is considered to be most suitable for organising business activities on a large scale as it does not suffer from the limitations of capital and management of other forms of organisation. The sole proprietorship, partnership and Co-operative organisation are not capable of undertaking large scale activity due to lack of adequate capital and limited managerial abilities. In a company organisation those problems can be easily overcome. It has the advantage of attracting huge capital from the public due to the limited liability of members. With adequate capital it can also employ trained and experienced managers to run the business activities efficiently.

**3.5.1 Meaning**

A company is defined as a voluntary association of persons having separate legal existence, perpetual succession and a common seal. As per the definition, there must be a group of persons who voluntarily agree to form a company. Once formed the company becomes a separate legal entity with a distinct name of its own. Its existence is not affected by change of members. It must have a seal to be imprinted on documents whenever required. The capital of a company consists of transferable shares, and members have limited liability.

**3.5.2 Features of a Company**

The following are the chief characteristics of the company form of organisation:

- (i) Registered body:** A company comes into existence only after its registration. For that purpose, necessary legal formalities have to be completed as prescribed under the Companies Act.
- (ii) Distinct legal entity:** A company is regarded as a legal entity separate from its members. Thus a company can carry on business in its own name, enter into contracts, sue, and be sued.
- (iii) Artificial person:** A company is the creation of law and has a distinct entity. It is therefore, regarded as an artificial person. The business is run in the name of the company. But because it is an artificial person, its functions are

performed by the elected representatives of members, known as directors.

- (iv) **Perpetual succession:** A company has continuous existence independent of its members. Death, insolvency, or change of members has no effect on the life of a company. The common saying in this regard is that members may come, members may go, but the company goes on forever. The life of the company can come to an end only through the prescribed legal procedure.
- (v) **Common seal:** Since a company is an artificial person, it has no physical existence. The activities of the company are carried through a group of natural persons elected by its members (called directors). Every company must therefore, have a common seal with its name engraved on it. Anyone acting on behalf of the company must use the common seal to bind the company.
- (vi) **Limited liability:** The liability of the members of a company is limited. It is limited to the extent of capital agreed to be contributed. Beyond that amount, the members cannot be personally held liable for payment of the company's debts.
- (vii) **Transferability of shares:** The capital of a company is divided into parts called shares. Normally the shares of a company are freely transferable by its members. However, transferability is restricted in the case of private company.

### 3.5.3 Merits of Company

The most important advantages of a company organisation may be stated as follows:

- (i) **Collection of huge financial resources:** The biggest advantage of a company organisation is that it has the ability to collect large amounts of funds. This is because a company can raise capital by issuing shares to a large number of persons. Shares of small value can be subscribed even by people with small savings. In addition, company can also raise loans from the public as well as different lending institutions. Availability of necessary funds makes it possible for a company to undertake business activities on a large scale.
- (ii) **Limited liability:** Another advantage of the company form of organisation is the limited liability of members. With



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the liability of members limited to the value of their shares, company is able to attract many people to invest in its shares. It is thus in a position to undertake business ventures involving risks.

- (iii) Free transferability of shares:** A company permits its members to transfer their shares. Free transferability of shares provides liquidity of the member's investment. Thus, if a member needs cash he can sell his shares. Or, he can use the same amount to buy shares of another more profitable company. It enables profitable companies also to attract funds away from the less profitable ones.
- (iv) Durability and stability:** A company is the only form of organisation which enjoys continuous existence and stability. The funds invested in a company by shareholders are not withdrawal until it is wound up. Also any change in the company's membership does not affect its life. As a result of this, a company can undertake projects of long duration and attract people to invest in the business of the company.
- (v) Growth and expansion:** With the large resources at its command a company can organize business on a large scale. Once the business is started on a large scale it gives the company strength to grow and expand. This is because of high profits, which accrue from the economies of large-scale organisation and production.
- (vi) Efficient management:** Since a company undertakes large-scale activities, it requires the services of expert professional managers. Competent managers can be easily hired by a company because it commands large financial resources. Thus, efficient management is ensured in a company organisation.
- (vii) Public confidence:** A company enjoys great confidence and trust of the general people. Companies have to disclose the results of their activities and financial position in the annual reports. The reports are available to the public. It is on the basis of the annual reports and other information that investment is made in companies.
- (viii) Social benefits:** Apart from the benefits mentioned above, a company organisation also offers the following social benefits:

- (a) **Democratisation of management:** In the company form of organisation, management of business is entrusted to the elected representative of shareholders, that is the directors. As a result of democratic management the business of company is run in the best interest of the majority shareholders.
- (b) **Dispersal of ownership:** Since a large number of persons are associated with a company as members, its ownership is widely held. Thus the benefits of the company's operations are distributed among a large section of people.
- (c) **Assumption of social responsibilities:** Large companies often undertake and contribute to social welfare activities by making donations to schools and colleges, developing rural areas, running health-care institutions, and so on.



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### 3.5.4 Limitations of Company Organisation

A company organisation suffers from the following limitations:

- (i) **Lengthy and expensive legal procedure:** The registration of a company is a long-drawn process. A number of documents are to be prepared and filled. For preparing documents experts are to be hired who charge heavy fees. Besides, registration fees have also to be paid to the Registrar of Companies.
- (ii) **Excessive government regulations:** A company is subject to government regulations at every stage of its working. A company has to file regular returns and statements of its activities with the Registrar. There is a penalty for non-compliance of the legal requirements. Filing returns and reports involving considerable time and money is the responsibility of a company. All this reduces flexibility in operations.
- (iii) **Lack of incentive:** The company is not managed by shareholders but by directors and other paid officials. Officials do not have investment in the company and also do not bear the risks. As such, they may not be as much motivated to safeguard the interests of the company as the shareholders.
- (iv) **Delay in decision-making and action:** In large companies,

**Notes**

decision making and its implementation happen to be a time consuming process. This is obviously because individual managers are unable to take decisions on their own. They may have to consult others which may take a lot of time. Similarly, after decisions are taken, they have to be communicated to people working at various levels of the organisation. It also delays the implementation of already delayed decisions.

- (v) **Conflict of interest:** A company is generally characterised by a large organisation with many groups operating in it. So long as the interests of these groups do not clash with each other they work for the good of the organisation. But sometimes, individual and group interests become difficult to reconcile. For instance, the sales manager may be interested in the quality of products to satisfy customers and increase sales, but the production manager may be more concerned with maximum production without regard to the product quality. In such a situation, the business is bound to suffer in course of time unless there is a reconciliation of the conflicting view points of the two managers.
- (vi) **Oligarchic management:** The company management may seem to be fully democratic, but in actual practice, it is the worst form of oligarchy i.e. control by a small group of persons. People who are once elected as directors of a company adopt various means to get themselves re-elected over and over again. Such individuals often exploit the company for personal interests instead of working in the interest of shareholders.
- (vii) **Speculation:** In speculation, profit is fought to be made by manipulating prices of shares without actually holding shares. A company organisation provides scope for speculation in shares by the directors. Because directors have knowledge of all information about the functioning of Company, they can use it to their personal advantage. For example, directors may sell or buy shares knowing that prices will decline or go up because of low or high profits. As a result of this, innocent shareholders may suffer loss.

**(viii) Growth of monopolistic tendencies:** A company because of its large size has the tendency to grow into a monopoly so as to eliminate competition, control the market and charge unreasonable prices to maximise profits. .

**(ix) Influencing government decisions:** Big companies are generally in a position to influence government officials to make decision in their favour. This is because such companies have large financial resources and are in a position to bribe even high officials.

From the preceding discussion it is clear that the company form of organisation is best suited to those lines of business activity which are to be organised on a large scale, require heavy investment of capital with limited liability of members. That is why enterprises producing steel, automobiles, computers and high technology products are generally organised as companies.

### **3.6 Limited Liability Partnership (LLP)**

#### **Meaning**

LLP, a legal form available world-wide is now introduced in India and is governed by the Limited Liability Partnership Act 2008, with effect from April 1, 2009..

LLP combines the advantages of ease of running a Partnership and separate legal entity status and limited liability aspect of a Company.

#### **3.6.1 Main features of a LLP**

- I. LLP is a separate legal entity separate from its partners, can own assets in its name, sue and be sued.
- II. Unlike corporate shareholders, the partners have the right to manage the business directly
- III. One partner is not responsible or liable for another partner's misconduct or negligence.
- IV. Minimum of 2 partners and no maximum.



**Notes**

**Notes**

- V. Should be 'for profit' business.
- VI. Perpetual succession.
- VII. The rights and duties of partners in LLP, will be governed by the agreement between partners and the partners have the flexibility to devise the agreement as per their choice. The duties and obligations of Designated Partners shall be as provided in the law.
- VIII. Liability of the partners is limited to the extent of his contribution in the LLP. No exposure of personal assets of the partner, except in cases of fraud.
- IX. LLP shall maintain annual accounts. However, audit of the accounts is required only if the contribution exceeds Rs. 25 lakhs or annual turnover exceeds Rs.40 lakhs.

**3.6.2 Merits**

- a. Lower cost of formation.
- b. Lesser compliance requirements.
- c. Easy to manage and run.
- d. Easy to wind-up and dissolve.
- e. No requirement of minimum capital contributions.
- f. Partners are not liable for the acts of the other partners.
- g. No minimum alternate tax (as of date).

**3.6.3 Demerits**

- a. LLP cannot raise money from the public.
- b. Financial Institution may not lend the large amount the LLP.

**3.6.4 Process for incorporating a LLP**

The Registrar of Companies (ROC) is the authority having jurisdiction over the incorporation.

- a. Decide on the Partners and the Designated Partners.
- b. Obtain Designated Partner Identification Number (DPIN) and a digital signature certificate.

- c. Decide on the name of the LLP and check whether it is available.
- d. Draft the LLP agreement
- e. File the LLP Agreement, incorporation documents and obtain the Certificate of Incorporation.

### 3.6.5 Distinction of Company, partnership firm and LLP

Features	Company	Partnership firm	LLP
Registration	Compulsory registration required with the ROC. Certificate of Incorporation is conclusive evidence.	Not compulsory. Unregistered Partnership Firm will not have the ability to sue.	Compulsory registration required with the ROC
Name	Name of a public company to end with the word "limited" and a private company with the words "private limited"	No guidelines.	Name to end with "LLP" Limited Liability Partnership
Capital contribution	Private company should have a minimum paid up capital of Rs. 1 lakh and Rs.5 lakhs for a public company	Not specified	Not specified
Legal entity status	Is a separate legal entity	Not a separate legal entity	Is a separate legal entity
Liability	Limited to the extent of unpaid capital.	Unlimited, can extend to the personal assets of the partners	Limited to the extent of the contribution to the LLP.
No. of shareholders / Partners	Minimum of 2. In a private company, maximum of 50 shareholders	2- 20 partners Minimum of	2. No maximum.
Foreign Nationals as shareholder / Partner	Foreign nationals can be shareholders.	Foreign nationals cannot form partnership firm.	Foreign nationals can be partners.


**Notes**





**Notes**

Taxability	The income is taxed at 30% + surcharge+cess	The income is taxed at 30% + surcharge+cess	Not yet notified.
Meetings	Quarterly Board of Directors meeting, annual shareholding meeting is mandatory	Not required	Not required.
Annual Return	Annual Accounts and Annual Return to be filed with ROC	No returns to be filed with the Registrar of Firms	Annual statement of accounts and solvency & Annual Return has to be filed with ROC

**3.6 SUMMARY**

**CHOICE OF FORM OF ORGANISATION**

Having discussed the characteristics, merits, limitations of the various form of organisation (sole proprietorship, partnership, co-operative and company organisation) we may consider how to select most suitable form of organisation for a business venture. Choice of a suitable form of organisation is important because the success and growth of a business depends a great deal on it. The form of organisation determines availability of finance, risk associated with business, division of profit, owners' control, Stability and durability of business, and so on. Since business and entrepreneurial objectives vary, no single form of organisation can be considered as the best for all kind of business. The selection of a suitable form of organisation is generally made after careful consideration of the following factors:

- (i) Scale of operations-manufacturing, trading, service;
- (ii) Scale of operations-volume of business (small, medium, large) and the market area served (local, national, international);
- (iii) Financial requirements for starting and expanding business;
- (iv) Degree of direct control desired by owners;
- (v) Degree of risk and liability;
- (vi) Division of profit;

- (vii) Flexibility of operations;
- (viii) Stability of business;
- (ix) Legal procedure.

It needs to be emphasized that these factors are inter-related and influence each other. For instance, the financial requirements of a business depend upon the nature of business as well as the scale of operations. The establishment of an industrial enterprise on a large scale would need greater outlay of the capital, than a small enterprise for the same purpose. Similarly, the degree of risk and liability will depend both on the amount invested and the nature of demand for the products of the enterprise. Thus, for a small enterprise (say, a workshop or a grocery shop) the risk will be limited and so will be the owner's liability, even if his personal assets may be used to discharge business debts. Control and sharing of profit are interconnected and both are related to the risk and liability. If the risk and liability are not heavy, the entrepreneur would not like to give up control and share profits with others.

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### 3.7 TERMINAL QUESTIONS

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1. Explain the features of partnership.
2. Distinguish between Private & Public company.
3. Write short note on
  - a) Co-operative organization
  - b) Sole proprietorship

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### 3.8 OBJECTIVE TYPE QUESTIONS

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1. There are \_\_\_ forms of business organization.( four/five)
2. Choose the correct option
  - a. Limited liability of the partners in Limited liability Partnership
  - b. Shareholders have limited liability
  - c. Single proprietor has unlimited liability.
  - d. All the above



**Notes**

**Notes**

3. Statement A: A Partnership deed is basic document in partnership  
Statement B: LPP should be registered with the Registrar of Companies.  
a. Only A is true   b. Only B is true   c. Both are true   d. Neither of two
4. Choose the wrong option  
a. Maximum partners can be 20 in the partnership firm.  
b. Maximum partners can be unlimited in LLP  
c. Maximum shareholders are unlimited in private company  
d. Sole proprietorship cannot have the partner.
5. Choose the correct option  
Statement A: Cooperative organization is a voluntary association.  
Statement B: Every member has the equal rights in the Cooperative organization.  
a. Only A is true   b. Only B is true   c. Both are true   d. Neither of two
6. Choose the correct option  
Statement A: Partnership has legal entity.  
Statement B: LPP has no legal entity.  
a. Only A is true   b. Only B is true   c. Both are true   d. Neither of two
7. Choose the correct option  
Statement A: There should be minimum Directors 2 in private company.  
Statement B: There should be maximum 20 directors in a partnership firm.  
a. Only A is true   b. Only B is true   c. Both are true   d. Neither of two
8. Choose the correct option  
a. Shares in a company are transferrable.

- b. Shares in LPP are transferable.
  - c. Share can be returned to the society
  - d. All the above
9. Choose the correct option
- Statement A: The service is the motive of the cooperative societies.
- Statement B: LPP is also formed to serve society.
- a. Only A is true   b. Only B is true   c. Both are true   d. Neither of two
10. Choose the wrong option
- a. Minimum 2 and maximum 50 shareholders in private limited company
  - b. Minimum 2 and maximum unlimited shareholders in public limited company
  - c. Minimum 2 and maximum unlimited partners in LPP
  - d. None of them

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**3.9 ANSWERS TO INTEXT QUESTIONS**

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**3.1**

- 1. The liability of sole proprietor ship firm is unlimited.
- 2. Minimum two persons are required to form a partnership firm.
- 3. No, it is not compulsory but there are certain advantages to get a firm registered.

**3.2**

- 1. The main aim is to serve the members.
- 2. Each member has one vote irrespective of the shares held by him.

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**3.10 ANSWERS TO OBJECTIVE TYPE QUESTIONS**

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- |         |      |      |      |       |
|---------|------|------|------|-------|
| 1. five | 2. d | 3. c | 4. c | 5. c  |
| 6. d    | 7. a | 8. d | 9. a | 10. d |

**Notes**