CHAPTER 2

FORMS OF BUSINESS ORGANISATION

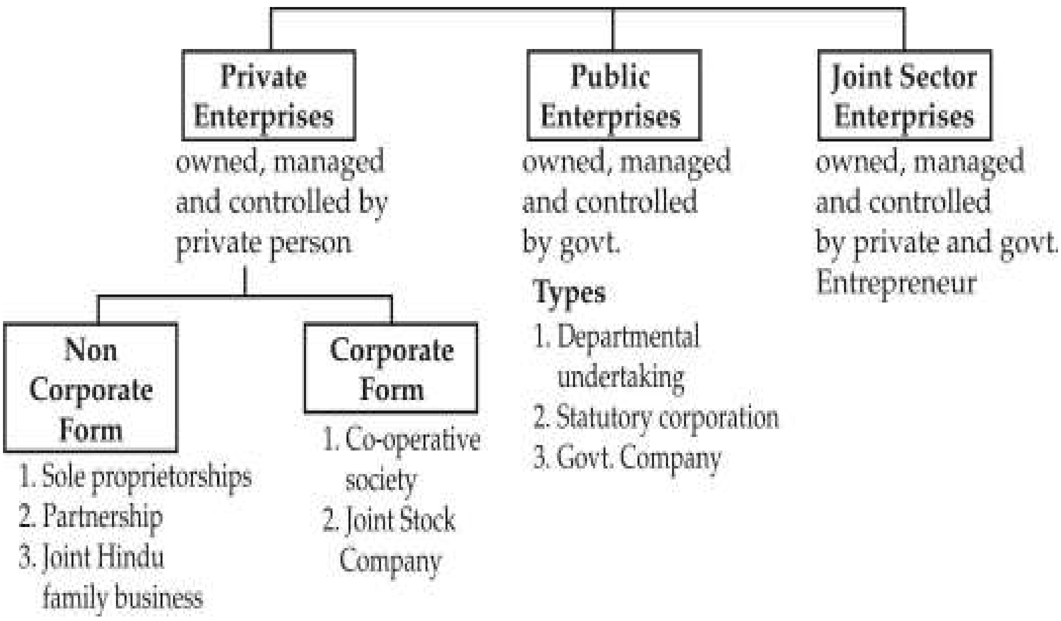
Meaning

A business enterprise is an institutional arrangement to form any business activity.

Classification

On the basis of ownership business enterprises can broadly be classified into the following categories :

Forms of Business Enterprise



In case of CORPORATE FORM of private enterprises the identity of the enterprise is separate from that of the owner and in case of NON CORPORATE FORM, the identity of the enterprise is not different from that of its owners.

SOLE PROPRIETORSHIP

Sole proprietorship means a business owned, financed and controlled by a single person who is recipient of all profits and bearer of all risks.

It is suitable in areas of personalised services like beauty parlour, hair cutting saloons and small scale activities like retail shops.

FEATURES

1. Single ownership :- It is wholly owned by one individual.
2. Control :- Sole proprietor has full power of decision making.
3. No Separate Legal Entity :- Legally there is no difference between business and businessman.
4. Unlimited Liability :- The liability of owner is unlimited. In case the assets of business are not sufficient to meet its debts, the personal property of owner can be used for paying debts.
5. No legal formalities :- are required to start, manage and dissolve such business organisation.
6. Sole risk bearer and profit recipient :- He bears the complete risk and there is nobody to share profit / loss with him.

MERITS

1. Easy to start and close :- It can be easily started and closed without any legal formalities.
2. Quick decision making :- as sole trader is not required to consult or inform anybody about his decisions.
3. Secrecy :- He is not expected to share his business decisions and secrets with anybody.
4. Direct incentive :- Direct relationship between efforts & reward provide incentive to the sole trader to work hard.
5. Personal touch :- The sole trader can maintain personal contacts with his customers and employees.
6. Social Utility :- It provides employment to persons with limited money who are not interested to work under others. It prevents concentration of wealth in few hands.

LIMITATIONS

1. Limited financial resources :- funds are limited to the owner s personal savings and his borrowning capacity.
2. Limited Managerial ability :- Sole trader cann t be good in all aspects of business and he cann t afford to employ experts also.
3. Unlimited liability :- of sole trader compels him to avoid risky and bold business decisions.
4. Uncertain life :- Death, insolvency, lunacy or illness of a proprietor affects the business and can lead to its closure.
5. Limited scope for expansion :- Due to limited capital and managerial skills, it cannot expand to a large scale.

SUITABILITY :

Sole tradership is suitable.

* Where the personal attention to customer is required as in tailoring, beauty parlour.

* Where goods are unstandardised like artistic jewellery.
* Where modest capital & limited managerial skills are required as in case of retail store.

JOINT HINDU FAMILY BUSINESS

It is owned by the members of undivided joint Hindu family and managed by the eldest member of the family known as KARTA. It is governed by the provisions of Hindu law. The basis of membership is birth in a particular family.

FEATURES

1. Formation - for a joint hindu family business there should be atleast two members in the family and some ancestral property to be inherited by them.
2. Membership - is by virtue of birth in the family.
3. Control - In it, control lies with eldest member of family known as Karta . All other members can give only advice.
3. Liability - of Karta is unlimited but of all other members is limited to the extent of their share in property.
4. Continuity - The business is not affected by death or incapacity of Karta as in such cases the next senior male member becomes the Karta.
6. Minor members - A minor can also become full fledged member of Family business.

MERITS

1. Effective control - The Karta can promptly take decisions as he has the absolute decision making power.
2. Continued business existence - The death, Lunacy of Karta will not affect the business as next eldest member will then take up the position.

3.. Limited liability - The liability of all members except Karta is limited. It gives them a relief.

4.Secrecy - Complete secrecy regarding business decisions can be maintained by Karta.

5. Loyality and co-operation - It helps in securing better co-operation and greater loyality from all the members who run the business.

LIMITATIONS

1. Limited capital - There is shortage of capital as it is limited to the ancestral property.

2. Unlimited liability of Karta - It make him less enterprising.
3. Dominance of Karta - Karta manages the business and sometimes he ignores the valueable

advice of other members. This may cause conflict among members and may even lead to break down of the family unit.

4. Hasty decisions - As Karta is overburdened with work. So sometimes he takes hasty and unbalanced decisions.
5. Limited managerial skills of Karta also poses a serious problem. The joint Hindu family business is on decline because of the diminishing no. of Joint Hindu families in the country.

PARTNERSHIP

Meaning : Partnership is a voluntary associations of two or more persons who agree to carry on some business jointly and share its profits and losses.

The partnership was evolved to overcome the shortcomings of sole proprietorship and Joint Hindu Family business.

FEATURES

1. Two or more persons - There must be atleast two persons to form a partnership. The maximum no. of persons is 10 in banking business and 20 in non banking business.
2. Agreement - It is an outcome of an agreement among partners which may be oral or in writing.
3. Lawful business - It can be formed only for the purpose of carrying on some lawful business.
4. Decision making & control - Every partner has a right to participate in management & decision making of the organisation.
5. Unlimited liability - Partners have unlimited liability.
6. Mutual Agency - Every partner is an implied agent of the other partners and of the firm. Every partner is liable for acts performed by other partners on behalf of the firm.
7. Lack of continuity - firms existence is affected by the death, Lunacy and insolvency of any of its partner. It suffers from lack of continuity.

MERITS

1. Ease of formation & closure - It can be easily formed. Only an agreement among the partners is required.
2. Larger financial resources - There are more funds as capital is contributed by no. of partners.
3. Balanced Decisions - as decisions are taken jointly by partners after consulting each other.
4. Sharing of Risks - In it, risk get distributed among partners which reduces anxiety, burden and stress on individual partner.
5. Secrecy - Secrecy can be easily maintained about business affairs as they are not required to publish their accounts or to file any report to the govt.

LIMITATIONS

1. Limited resources - There is a restriction on the number of partners and hence capital contributed by them is also limited.
2. Unlimited liability- The liability of partners is unlimited and they are liable individually as well as jointly. It may prove to be a big drawback for those partners who have greater personal wealth. They will have to repay the entire debt in case the other partners are unable to do so.
3. Lack of continuity - Partnership comes to an end with the death, retirement, insolvency or lunacy of any of its partner.
4. Lack of public confidence - Partnership firms are not required to publish their reports and accounts. Thus they lack public confidence.

TYPES OF PARTNERS

1. General / Active Parter - Such a partner takes active part in the management of the firm.
2. Sleeping or Dormant Partner - He does not take active part in the management of the firm. Though he invest money, shares profit & Loss, has unlimited liability.
3. Secret Partner - He participates in business secretly without disclosing his association with the firm to general public. His liability is also unlimited.
4. Nominal Partner - Such a partner only gives his name and goodwill to the firm. He neither invests money nor takes profit. But his liability is unlimited.
5. Partner by Estoppel - He is the one who by his words or conduct gives impression to the outside world that he is a partners of the firm whereas actually he is not. His liability is unlimited towards the third party who has entered into dealing with firm on the basis of his pretention.
6. Partner by holding out - He is the one who is falsely declared partner of the firm wheras actually he is not. And even after becoming aware of it, he does not deny it. His liability is unlimited towards the party who has deal with firm on the basis of this declaration.

PARTNERSHIP DEED

The written agreement on a stamped paper which specifies the terms and conditions of partnership is called the partnership deed.

It generally includes the following aspects -

- Name of the firm
- Location / Address of the firm

- Duration of business.
- Investment made by each partner.
- Profit sharing ratio of the partners.
- Terms relating to Salaries, Drawing, Interest on capital and Interest on Drawing of partners.
- Duties and obligations of partners.
- Terms governing admission, retirement and expulsion of a partner.
- Preparation of accounts and their auditing.
- Method of solving disputes.

REGISTRATION OF PARTNERSHIP

Registration is not compulsory, it is optional. But it is always beneficial to get the firm registered.

The consequences of non-registration of a firm are as follows -

1. A partnet of an unregistered firm cannot file suit against the firm or other partner.
2. The firm cannot file a suit against third party.
3. The firm cannot file a case against its partner.

CO-OPERATIVE SOCIETY

A cooperative society is a voluntary association of persons of moderate means, who unite together to protect and promote their common economic interests.

FEATURES

1. Voluntary association - Everyone having a common interest is free to join a cooperate society and can also leave the society after giving proper notice.
2. Legal status - Its registration is compulsary and it gives it a separate legal identity.
3. Limited liability - The liabity of the member is limited to the extend of their capital contribution in the society.
4. Democratic control - Management and control lies with the managing committee elected by the members by giving vote. Every member has one vote irrespective of the number of shares held by him.
5. Service motive - The main aim is to serve its members and not to maximise the profit.
6. State control - They have to abide by the rules and regulation framed by govt. for them.
7. Distribution of surplus - The profit is distributed on the basis of volume of business transacted by a member and not on the basis of capital contribution of member.

MERITS

1. Ease of formation - It can be started with minimum of 10 members. Registration is also easy as it requires very few legal formalities.
2. Limited liability :- The liability of members is limited to the extend of their capital contribution.
3. Stable Existence - Due to registration it is a separete legal entity and is not affected by the death, Lunacy or insolvency of any of its member.
4. Economy in operations - Due to elimination of middleman and voluntary services provided by its members.
5. Government Support - Govt. provides support by giving loans at lower interest rates, subsidies & by charging less taxes.
6. Equality in voting status:- the principle of ONE MAN ONE VOTE, govern the society. Each member has equal vote, irrespective of capital contribution.

LIMITATIONS

1. Shortage of capital - It suffers from shortage of capital as it is usually formed by people with limited means.
2. Inefficient management - Co-operative society is managed by elected members who may not be competent and experienced. Moreover it cann t afford to employ expert and experienced people at high salaries.
3. Lack of motivation - Members are not inclined to put their best efforts as there is no direct link between efforts and reward.
4. Lack of Secrecy - Its affairs are openly discussed in its meeting which makes it difficult to maintain secrecy.
5. Excesive govt. control - it suffers from excessive rules and regulations of the govt. It has to get its accounts audited by the auditor and has to submit a copy of its accounts to registrar.
6. Conflict among members - The members are from different sections of society with different view points. Sometimes when some members become rigid, the result is conflict.

TYPES OF CO-OPERATIVE SOCIETIES

1. Consumers co-operative Society - It seeks to eliminate middleman by establishing a direct link with the producers. It purchases goods of daily consumption directly from manufacturer or wholesalers and sells them to the members at reasonable prices.
2. Producer s Co-operative Society - The main aim is to help small producers who cannot easily collect various items of production and face some problem in marketing. These societies

purchase raw materials, tools, equipments and other items in large quantity and provide these things to their members at reasonable price.

3. Marketing Co-operative Society - It performs various marketing function such as transportation, warehousing, packing, grading, marketing research etc. for the benefit of its members. The production of different members is pooled together and sold by society at good price.
4. Farmer s Co-operative Society - In such societies, small farmers join together and pool their resources for cultivating their land collectively. Such societies provide better quality seeds, fertilisers, machinery and other modern techniques for use in the cultivation of crops. It provides them opportunity of cultivation on large scale.
5. Credit co-opearative Society - Such societies protect the members from exploitation by money lenders. They provide loans to their members at easy terms and reasonably low rate of interest.
6. Co-operative Housing Society - The main aim is to provide houses to people with limited means / income at reasonable price.

JOINT STOCK COMPANY

Meaning - Joint stock company is a voluntary association of persons having a separate legal existence, perpetual succession and common seal. Its capital is divided into transferable shares.

FEATURES

1. Seperate Legal Existence - It is created by law and it is a distinct legal entity independent of its members. It can own property, enter into contracts, can file suits in its own name.
2. Perpetual Existence - Death, insolvency and insanity or change of members has no effect on the life of a company It can come to an end only through the prescribed legal procedure.
3. Limited Liability - The liability of every member is limited to the nominal value of the shares bought by him or to the amt. guaranted by him.
4. Transferability of shares - Shares of public Co. are easily transferable. But there are certain restrictions on transfer of share of private Co.
5. Common Seal - It is the official signature of the company and it is affixed on all important documents of company.
6. Seperation of ownership and conrol - Management of company is in the hands of elected representatives of shareholders known individually as director and collectively as board of directors.

MERITS

1. Limited Liability - Limited liability of shareholder reduces the degree of risk borne by him.
2. Transfer of Interest - Easy transferability of shares increases the attractiveness of shares for investment.
3. Perpetual Existence - Existence of a company is not affected by the death, insanity, Insolvency of member or change of membership. Company can be liquidated only as per the provisions of companies Act.
4. Scope for expansion - A company can collect huge amount of capital from unlimited no. of members who are ready to invest because of limited liability, easy transferability and chances of high return.
5. Professional management - A company can afford to employ highly qualified experts in different areas of business management.

LIMITATIONS

1. Legal formalities - The procedure of formation of Co. is very long, time consuming, expensive and requires lot of legal formalities to be fulfilled.
2. Lack of secrecy - It is very difficult to maintain secrecy in case of public company, as company is required to publish and file its annual accounts and reports.
3. Lack of Motivation - Divorce between ownership and control and absence of a direct link between efforts and reward lead to lack of personal interest and incentive.
4. Delay in decision making - Red tapism and bureaucracy do not permit quick decisions and prompt actions. There is little scope for personal initiative.
5. Oligarchic management - Co. is said to be democratically managed but actually managed by few people i.e. board of directors. Sometimes they take decisions keeping in mind their personal interests and benefit, ignoring the interests of shareholders and Co.

SUFFER THE PAIN OF DISCIPLINE
OR SUFFER THE PAIN OF REGRET

TYPES OF COMPANIES

On the basis of ownership, companies can be divided into two categories

- Private & Public. Difference between Private Company & Public Co.

	Private Co.		Public Co.
i)	It has minimum 2 & maximum 200 member	i)	It has minimum 7 & maximum unlimited members.
ii)	It cannot invite general public to buy its shares & debentures	ii)	It invites general public to buy its shares & debentures
iii)	There are certain restrictions on tranfer of its shares.	iii)	Its share are freely transferable
iv)	It can commence bussiness after incorporation	iv)	It can commence business after obtaining certificate of commencement of business
v)	It has to write Private Ltd after its name **Example :** Tata Sons, Citi Bank, Hyundai Motor India	v)	It has to write only Limited after its name **Example :** Reliance Industries Ltd., Wipro Ltd., Raymonds Ltd.

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CHOICE OF FORM OF BUSINESS ORGANISATION

The following factors are Important for taking decision about form of organisation.

1. Cost and Ease in Setting up the organisation - Sole properietorship is least expensive and can be formed without any legal formalities to be fulfilled. Company is most expensive with lot of legal formalities,
2. Capital Consideration - Business requiring less amount of finance prefer sole proprietorship and partnership form, where as business activites requiring huge financial resources prefer company form.
3. Nature of Business - If the work requires personal attention such as tailoring unit, hair cutting saloon, it is generally set up as a sole proprietorship. Units engaged in large scale manufacturing are more likely to be organised in company form.

4. Degree of Control Desired - A person who desires full and exclusive control over business prefers proprietorship rather than partnership or Co. because control has to be shared in these cases.
5. Liability or Degree of Risk - Projects which are not very risky can be organised in the form of sole proprietorship & partnership. Where as the risky ventures should be done in company form of organisation because the liability of shareholders is limited.

FORMATION OF A COMPANY

Formation of a company means bringing a company into existence and starting its business. The steps involved in the formation of a company are :-

i) Promotion
ii) Incorporation
iii) Capital subscription
iv) Commencement of business.

A private company has to under go only first two steps but a publc company has to undergo all the four stages.

I. Promotion :-

Promotion means conceiving a business opportunity and taking an initiative to form a company.

Step in Promotion :-

1. Identification of Business Opportunity : The first and foremost function of a promoter is to identify a business idea e.g. production of a new product or service.
2. Feasibility Studies :- After identifying a business opportunity the promoters undertake detailed studies of technical, Financial, Economic feasibility of a business.
3. Name Approval : After selecting the name of company the promotors submit an application to the Registrar of companies for its approval.
4. Fixing up signatories to the Memorandom of Association :- Promotors have to decide about the director who will be signing the memorandum of Association.
5. Appointment of professional : - Promoters appoint merchant bankers, auditors etc.
6. Preparation of necessary documents :- The promoters prepare certain legal documents such as memorandum of Association, Articles of Association which have to be submitted to the Registrar of the companies.

II. Incorporation :-

Incorporation means registration of the company as body corporate under the companies Act 1956 and receiving certificate of Incorporation.

Steps for Incorporation

1. Application for incorporation :- Promotors make an application for the incorporation of the company to the Registrar of companies.
2. Filing of necessary documents :- Promotors files the following documents:-
   i) Memorandum of Assoication.
   ii) Articles of Association.
   iii) Statement of Authorised Capital
   iv) Consent of proposed director.
   v) Agreement with proposed managing director.
   vi) Statutory declaration.
3. Payment of fees :- Along with filing of above documents, registration fees has to be deposited which depends on amount of the authorised capital.
4. Registration :- The Registrar verifies all the document submitted. If he is satisfied then he enters the name of the company in his Register.
5. Certificate of Incorporation :- After entering the name of the company in the register. The Registrar issues a Certificate of Incorporation . This is called the birth certificate of the company.

III. Capital Subscription :-

A public company can raise funds from the public by issuing shares and Debentures. For this it has to issue prospectus and undergo various other formalities:-

Step required for raising funds from public :

1. SEBI Approval : SEBI regulates the capital market of India. A public company is required to take approval from SEBI.
2. Filing of Prospectus :- Prospectus means any documents which invites offers from the public to purchase share and Debenture of the company.
3. Appointment of bankers, brokers, underwriters :- Banker of the company receive the application money. Brokers encourage the public to apply for the shares. underwriters are the person who undertake to buy the shares if these are not subscribed by the public. They receive a commission for underwriting.

4. Minimum subscription : According to the SEBI guide lines minimum subscription is 90% of the issue amount. If minimum subscription is not received then the allotment cannot be made and the application money must be returned to the applicants within 30 days.
5. Application to Stock Exchange :- It is necessary for a public company to list their shares in the stock exchange therefore the promoters apply in a stock exchange to list company shares.
6. Allotment of Shares : Allotment of shares means acceptance of share applied. Allotment letters are issued to the shareholders. The name and address of the shareholders submitted to the Registrar.

IV. COMMENCEMENT OF BUSINESS :-

To commence business a public company has to obtain a certificate of commencement of Business. For this the following documents have to be filled with the registrar of companies.

1. A declaration that 90% of the issued amount has been subscribed.
2. A declaration that all directors have paid in cash in respect of allotment of shares made to them.
3. A statutory declaration that the above requirements have been completed and must be signed by the director of company.

1 MARK QUESTIONS :-

1. Write the name of form of business organisation found only in India.
2. Name two types of business in which sole propritorship is very suitable.
3. Name the person who manages a Joint Hindu Family business.
4. Write the names of systems which govern membership in Joint Hindu Family Business.
5. Enumerate the two conditions necessary for formation of Joint Hindu Family business.
6. What is the minimum no. of persons required to form a co operative society?
7. Name the type of Co. which must have a minimum paid up capital of 5 lacs
8. What is meant by minimum subscription?