Types of Business Organization

CLASS-VIII

ECONOMICS

What is a firm?

- A **firm** is a *unit of management*.
- It is an organization which trades under a particular name, and which controls the way in which land, labour and capital are used.
- A firm must be distinguished from a *unit of production* such as a factory, a farm, a mine, etc. One firm may own and control several units of production.
- Firms vary in **size** from *small* to *medium* and *large* enterprise.
- Firms may be **organized** in different ways in terms of *ownership* and *control*.

Types of Business Organization

- **Sole-traders/Sole-proprietors**
- **Partnerships**
- **Private Limited Companies**
- **Public Limited Companies (PLCs)**
- **Public Corporations**
- **Co-operative Societies**

Sole-trader or Sole-Proprietor

- **Sole-trader** is a business owned by one person.
- It is the oldest form of business organization and there are more sole-traders than any other type of firm.
- Many hundreds of such businesses are set up every day and, although many of them are successful, there is a large number of such firms closing down every day.
- Lack of experience of the people setting up a business for the first time, and insufficient funds to push through a 'bad patch', are probably the main reasons for the number of large failures.
- Sole-traders are common in retailing, farming, personal services (e.g. hairdressing), craft work and repair work.

Advantages of Sole-traders

- It is relatively easy and inexpensive to establish oneself as a sole-trader. It often requires little money and there are no complicated legal arrangements to be made.
- It is a flexible organisation in the sense that decision making can be done fast and smooth as the owner does not have to wait for meetings or seek consent of other owners as there are none.
- The owner can provide a personal service to the customers and hence directly control the quality of service besides getting first-hand customer feedback.
- There is a great incentive to work hard and be efficient as the owner gets all the rewards of success.

Disadvantages of Sole-traders

- The sole-trader has to bear all the risk of loss if the business fails.
- The sole-trader suffers from **unlimited liability** which means that if the business goes bankrupt, the owner is personally liable for the debts of the firm. His or her personal possessions may have to be sold to pay off the debts.
- It may be difficult for sole-traders to obtain loans (from banks) as banks consider it risky to provide loans to small businesses. The main source of finance is likely to be the proprietor's own savings, and loans from friends and relatives.
- A sole-trader may have limited experience and knowledge of business and does not have a partner to consult with.
- It can be stressful to run a business on one's own. However, a sole-trader can employ others to work for/manage the business.

Pros & Cons of Sole-traders at a glance

Advantages:

Easy to set up business

Makes all the decisions

Has complete control

Keeps the profit

Disadvantages:

Unlimited liability –
Responsible for business debts

May not be able to raise funds
to expand the business

May have to work long hours

Difficult to compete with
larger rival firms

May not have business skills to
run a business

Partnerships

- A **Partnership** is a form of business in which two or more people agree to jointly own a business.
- The partners will contribute to the capital of the business, will usually have a say in the running of the business and will share any profits made.
- In the UK, The Partnership Act, 1890 defines a partnership as a voluntary assosication of from 2 to 20 people which is formed to carry on business with a view to profit. However, in some professions such as law, accountancy and stockbroking, more than 20 people are now allowed to form a partnership.
- In Bangladesh, The Partnership Act, 1932 defines the laws regarding partnership.
- A **partnership agreement** is the written and legal agreement between business partners. It is not essential for partners to have such an agreement but it is always recommended.
- Partnerships are commonly found in farming, catering, retailing and building, and in professions such as law, medicine, and accountancy.

Advantages of Partnership

- With several people putting money into the business, a partnership can raise more capital than a sole trader.
- A Partnership business is relatively easy to set up.
- The management of the firm can be more specialised. Different partners can be made responsible for different departments, such as sales, administration, production and so on.
- More minds involved can lead to better decision making.

Disadvantages of Partnerships

- Partnerships also suffer from the disadvantage of *unlimited liability*. In ordinary partnerships, each partner is fully liable for the debts of the firm.
- Profits of the business must be shared with all partners.
- Disagreements may arise amongst partners and this can slow down decision making; moreover, Partnerships can be unstable as they are easy to break up.
- It may be difficult to raise further finance to expand the business.
- An **unincorporated business** is one that does not have a separate legal identity. Sole traders and partnerships are unincorporated businesses.

Pros & Cons of Partnerships at a glance

Advantages:

Easy to set up a Deed of Partnership

Partners invest in the business so greater access to funds

Shared decision making

Shared management and workload

Disadvantages:

Unlimited liability – responsible for business debts

Share the profits

Business ceases to exist if one partner leaves

Decisions binding on all partners

Difficult to raise finance

Company

- A **company** is an **incorporated business**, i.e., it has a separate legal unit from its owners.
- A company exists separately from the owners and will continue to exist if one of the owners should die.
- A company can make contracts or legal agreements.
- Company accounts are kept separate from the accounts of the owners.
- **Shareholders** are the owners of a limited company. They buy shares which represent part-ownership of the company. These shareholders appoint directors to run the business.
- Shareholders in a limited company have *limited liability*.
- **Limited liability** means that the liability of shareholders in a company is limited to only the amount they invested.
- **Dividends** are payments made to shareholders from the profits of a company. They are the return to shareholders for investing in the company.

Private Limited Companies

- **Private limited companies** are businesses owned by shareholders but they cannot sell shares to the public.
- In a private limited company, the directors are usually the most important or majority shareholders.
- Some examples of Private Ltd. companies in Bangladesh are - Scholastica Ltd., The Structural Engineers Ltd. (SEL), etc.

Public Limited Companies (PLCs)

Public limited companies are businesses owned by shareholders but they can sell shares to the public and their shares are tradeable on the Stock Exchange.

Some examples of public limited companies in Bangladesh are - Dutch-Bangla Bank Ltd. (DBBL), Beximco Pharmaceuticals Ltd., Square Pharmaceuticals PLC. Other examples of global PLCs are - Google LLC, Apple, ExxonMobil, etc.

NOTE: A Public Limited Company is NOT owned by the govt., though the govt. may have shares in it; PLCs belong to the private sector.

	Private limited company	Public limited company
Owners	Usually a very small number of shareholders. Often members of the same family or friends.	Usually a very large number of shareholders.
Size	Usually fairly small.	Most common form of organisation for very large companies.
Sale of shares by the company	Can only be sold privately, often to family members, friends or employees.	Can be offered for sale to the general public and other organisations.
Sale of shares by shareholders	Often difficult to sell as must be sold privately and with the agreement of other shareholders.	Quick and easy to sell as they can be offered for sale to the public.

	Private limited company	Public limited company
Control	Only a few shareholders. One shareholder may own 51% of the shares in the company and so has control over major decisions. Ownership is not separated from control.	Often thousands of shareholders. The Board of Directors appointed by shareholders at the Annual General Meeting control major decisions. Ownership and control are separated.
Raising additional capital through share issue	Even if successful it may be difficult to raise additional capital as shares cannot be sold to the general public.	If successful then can often raise very large sums quite easily through the sale of additional shares.
Borrowing finance	Often find it difficult to raise finance as unincorporated businesses because they are usually small businesses with low value assets to offer as security – known as **collateral**.	Can often raise very large sums at good rates of interest because of their reputation and valuable collateral.

Public Corporations

- A **public corporation** is a business in the public sector that is owned and controlled by the state (government).
- Public corporations are financed mainly through *taxation* & also through *loans*.
- They are usually businesses which have been nationalized. This means that they were once owned by private individuals, but were purchased by the govt.
- A public corporation has no shareholders.
- Examples of these in many countries include water supply and rail services, e.g., Bangladesh Railway (BR)
- Government does not directly operate the businesses. Government ministers appoint a Board of Directors, who will be given the responsibility of managing the business. The government will, however, make clear what the objectives of the business should be. The directors are expected to run the corporation according to these objectives.
- Public corporations may have social objectives rather than a profit objective. For example, to provide a service to the public and meet the needs of the less well-off in the population. The services of public corporations are often provided for free or at a low price to the population. However, in other cases, public corporations may also have a profit objective.

Co-operative societies (optional read)

There are two main types of co-operative society -

- **Worker co-operatives:** In this type of cooperative, the business is owned and controlled by those who work in it. The workers provide, or borrow, the money to set up the business. They take all the management decisions, either collectively, or by electing managers from their own ranks. Profits are shared out between the workers on some basis agreed amongst themselves. Worker cooperatives have proved to be very successful in Spain & France.
- **Consumer co-operatives:** In this type of cooperative the owners are the consumers. There is no maximum number of members and members are free to join or leave at any time. Each member has only one vote irrespective of the number of shares held. Members may receive a share of profits as cash dividend proportional to their investment or receive discounts on purchase of certain items. Members receive a fixed rate of interest on their share capital. The management of a consumer cooperative is the responsibility of a committee elected by the members while the elected committee may appoint other full-time managers to manage the day-to-day operations of the business.

THE END

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ALL THE BEST!