

## **Chapter 2**

### **Forms of Business Organization**

#### **Multiple Choice Questions**

Q. 1 The structure in which there is a separation of ownership and management is called

- A. Sole proprietorship
- B. Partnership
- C. Company
- D. All business organizations

Answer:

Company is a legal entity formed by a group of individuals to operate a business.

Q. 2 The Karta in Joint Hindu family business has

- A. Limited liability
- B. Unlimited liability
- C. No liability for debts
- D. Joint liability

Answer:

The Karta means the head of the family has unlimited liability over the business.

Q. 3 In a cooperative society, the principle followed is

- A. One share one vote
- B. One man one vote
- C. No vote

D. Multiple votes

Answer: In a cooperative society the principle one man one vote means members can vote only once.

Q. 4 The board of directors of a joint-stock company is elected by

A. General public

B. Government bodies

C. Shareholders

D. Employees

Answer:

The shareholders are the owners of the company while the Board of Directors is the chief managing body elected by the shareholders.

Q. 5 Profits do not have to be shared. This statement refers to

A. Partnership

B. Joint Hindu family business

C. Sole proprietorship

D. Company

Answer: In Joint Hindu family business profits are not shared as it is an ancestral property.

Q. 6 The capital of a company is divided into some parts, each one of which is called

A. Dividend

B. Profit

C. Interest

D. Share

Answer:

Share is a portion which is divided among several people that contributes to a company.

Q. 7 The Head of the joint Hindu family business is called

A. Proprietor

B. Director

C. Karta

D. Manager

Answer:

Karta is the oldest member in the family who holds control over the business.

Q. 8 Provision of residential accommodation to the members at reasonable rates is the objective of

A. Producer's cooperative

B. Consumer's cooperative

C. Housing cooperative

D. Credit cooperative

Answer:

Cooperative housing societies are established to help people with limited income to construct houses at reasonable costs.

Q. 9 A partner whose association with the firm is unknown to the general public is called

A. Active partner

B. Sleeping partner

C. Nominal partner

D. Secret partner

Answer:

Secret partner Contributes capital but Participates in management, secretly

### **Short Answer**

Q. 1 Compare the status of a minor in a Joint Hindu family business with that in a partnership firm.

Answer:

In a Joint Hindu family business, a minor male child enjoys equal ownership after his birth. He enjoys ownership over the property only to his share that he holds in the joint family.

Q. 2 If registration is optional, why do partnership firms willingly go through this legal formality and get themselves registered? Explain.

Answer:

The partners in a firm willingly go through legal formality though it is optional because the partners of non-registered firms cannot file suit against the third party. The firm cannot file a case against any of the partners if they are unlawful. Even they cannot claim against the third party in the court.

Q. 3 State the important privileges available to a private company.

Answer:

The important privileges available to a private company are as follows:

- i. A private company can be formed by two members whereas for a public company it requires at least seven members to form.
- ii. There is no minimum subscription for the allotment of the shares.

iii. After receiving the certificates of incorporation a private company can start the business. But a public company cannot start its business without receiving the certificate of commencement.

iv. A private company is not required to keep an index of members while the same is necessary in the case of a public company.

v. For the sanction of loans, a public company required permission to grant whereas there is no such restriction in private company.

Q. 4 How does a cooperative society exemplify democracy and secularism? Explain.

Answer:

A cooperative society exemplifies democracy and secularism as many of the features of democracy and secularism are seen in a co-operative setup. Here are some of the features-

- a. All members have voting rights and they can vote only once.
- b. All the decision is taken based on majority similar to democratic government.
- c. Membership is not restricted and opens for all irrespective of religion, caste, sex etc.

Q. 5 What is meant by 'partner by estoppel'? Explain.

Answer:

Partner by estoppel is meant a person who with their initiative gives an impression of being a partner of a firm. Such partners are considered as a partner even though they do not contribute to capital or a part in the management.

Q. 6 Briefly explain the following terms in brief.

(a) Perpetual succession

(b) Common seal

(c) Karta

(d) artificial person

Answer:

(a) perpetual succession: A company is created by law but cannot end by itself. It can be ceased with a specific procedure.

(b) Common seal: it is an agreement of legal binding. The company have sealed in place of signatures.

(c) Karta: Karta is the eldest member of the family who has all the decision making powers. He has the responsibility of carrying out the business operation and can exercise full control over it.

(d) Artificial person: An artificial person cannot breathe or talk but has all the rights and liabilities and work as a normal being. Example Company is an artificial person that can lend and borrow money.

### **Long Answer**

Q. 1 What do you understand by a sole proprietorship firm? Explain its merits and limitation?

Answer:

Sole Proprietorship refers to a form of business organization that is owned managed and controlled by an individual's who is the recipient of all profits and bearer of all risk.

Merits:

- i. A sole proprietorship can quickly decide as it enjoys a considerable degree of freedom.
- ii. There is hardly any legal formality for setting up a sole proprietorship firm.
- iii. There is a sense of accomplishment in working.

iv. A sole proprietorship is the recipient of all profits earned from business and this motivates others to carry out their business efficiently.

#### Limitation

i. Resources of a sole proprietor are limited because of the lending institutions that hesitate to extend long term loan

ii. There is a limited expectancy of business as a sole proprietor is responsible for everything including death and it may lead to the closure of the business.

iii. The creditors might recover its dues from the personal assets of the sole proprietor if possible.

Q. 2 Why is partnership considered by some to be a relatively unpopular form of business ownership? Explain the merits and limitations of partnership.

Answer:

Partnership considered by some to be a relatively unpopular form of business ownership as it has several limitations. But it has certain merits too. So here are some of them:

#### Merits:

i. Formation of a partnership firm is easy and its closure is also not a difficult task. One can form by signing an agreement.

ii. The decision-making process in a partnership form is more balanced as compared to another form of business.

iii. A large number of funds can be raised due to several partners involved in the business. This can help in the growth of the business.

iv. The risk involved in the business is shared by all the partners and hence helped in reducing risk by one only.

v. Confidentiality is an important feature of partnership firm and the members maintain secrecy in its operations.

#### Limitation

i. Partners have to repay debts from personal assets in case of insufficient resources.

ii. There is a restriction on the number of partners involved for which they cannot support large scale operation due to lack of resources.

iii. In partnership firm, the power of decision making is shared by the members. The differences in opinion result in conflict.

iv. A fresh agreement is required by the members to run their business if their partnership comes to an end.

v. There is a lack of public confidence as a partnership firm are not legally binding.

Q. 3 Why is it important to choose an appropriate form of organization? Discuss the factors that determine the choice of the form of organization.

Answer:

It is important to choose an appropriate form of organization to start a business so that it can be managed properly. The factors that determine the choice of the form of organization are as follows:

i. Initial business setting-up costs should be taken into concern such as sole proprietorship is the most inexpensive way of starting a business. In case of a partnership, the advantage of less legal formalities and lower cost is there because of the limited scale of operations. Cooperative societies and companies have to be compulsorily registered. Formation of a company involves a lengthy and expensive legal procedure. For the initial cost, therefore, a sole proprietorship is the preferred form as it involves the least expenditure. Company form of organization, on the other hand, is more complex and involves greater costs.



ii. In case of sole proprietorship and partnership firms, the liability of the owners/partners is unlimited. In a joint Hindu family business, only the Karta has unlimited liability. In cooperative societies and companies, however, liability is limited and creditors can force payment of their claims only to the extent of the company's assets. Hence, for investors, the company form of organization is more suitable as the risk involved is limited.

iii. The continuity of sole proprietorship and partnership firms is affected by such events as death, insolvency or insanity of the owners. However, such factors do not affect the continuity of business in the case of organizations like joint Hindu family business, cooperative societies and companies. In case the business needs a permanent structure, company form is more suitable. For short term ventures, proprietorship or partnership may be preferred.

iv. A sole proprietor may find it difficult to have expertise in all functional areas of management. In other forms of organizations like partnership and company, there is no such problem. Division of work among the members in such organizations allows the managers to specialize in specific areas, leading to better decision making. But this may lead to situations of conflicts because of differences of opinion amongst people.

v. Companies are in a better position to collect large amounts of capital by issuing shares to a large number of investors. Partnership firms also have the advantage of the combined resources of all partners. But the resources of a sole proprietor are limited. Thus, if the scale of operations is large, company form may be suitable whereas for medium and small-sized business one can opt for partnership or sole proprietorship. Further, for expansion, a company is more suitable because of its capability to raise more funds and invest in expansion plans.

vi. If direct control over operations and absolute decision-making power is required, proprietorship may be preferred. But if the owners do not

mind sharing control and decision making, partnership or company form of organization can be adopted. The added advantage in the case of company form of organization is that there is a complete separation of ownership and management and it is professionals who are appointed to independently manage the affairs of a company.

vii. If direct personal contact is needed with the customers such as in the case of a grocery store, proprietorship may be more suitable. For large manufacturing units, however, when direct personal contact with the customer is not required, the company form of organization may be adopted. Similarly, in cases where services of a professional nature are required, partnership form is much more suitable.

Q. 4 Discuss the characteristics, merits and limitation of the cooperative form of organization. Also, describe briefly different types of cooperative societies.

Answer:

The cooperative society is a voluntary association of persons, who join together with the motive of the welfare of the members.

The characteristics of a cooperative society are listed below.

(i) Voluntary membership: The membership of a cooperative society is voluntary. A person is free to join a cooperative society, and can also leave anytime as per his desire. There cannot be any compulsion for him to join or quit a society.

(ii) Legal status: Registration of a cooperative society is compulsory. This accords a separate identity to the society which is distinct from its members. As a result of being a separate legal entity, it is not affected by the entry or exit of its members.

(iii) Limited liability: The liability of the members of a cooperative society is limited to the extent of the amount contributed by them as

capital. This defines the maximum risk that a member can be asked to bear.

(iv) Control: In a cooperative society, the power to take decisions lies in the hands of an elected managing committee. The right to vote gives the members a chance to choose the members who will constitute the managing committee and this lends the cooperative society a democratic character.

(v) Service motive: The cooperative society through its purpose emphasizes the values of mutual help and welfare.

### Merits

(i) The principle of 'one man one vote' governs the cooperative society. Irrespective of the amount of capital contribution by a member, each member is entitled to equal voting rights.

(ii) The liability of members of a cooperative society is limited to the extent of their capital contribution. The personal assets of the members are, therefore, safe from being used to repay business debts.

(iii) Death, bankruptcy or insanity of the members do not affect the continuity of a cooperative society. A society, therefore, operates unaffected by any change in the membership.

(iv) The members generally offer honorary services to the society. As the focus is on the elimination of middlemen, this helps in reducing costs. The customers or producers themselves are members of the society, and hence the risk of bad debts is lower.

(v) The cooperative society exemplifies the idea of democracy and hence finds support from the Government in the form of low taxes, subsidies, and low-interest rates on loans.

(vi) The cooperative society can be started with a minimum of ten members. The registration procedure is simple involving a few legal

formalities. Its formation is governed by the provisions of the Cooperative Societies Act 1912.

### Limitations

(i) Resources of a cooperative society consist of capital contributions of the members with limited means. The low rate of dividend offered on investment also acts as a deterrent in attracting membership or more capital from the members.

(ii) Cooperative societies are unable to attract and employ expert managers because of their inability to pay them high salaries. The members who offer honorary services voluntarily are generally not professionally equipped to handle the management functions effectively.

(iii) As a result of open discussions in the meetings of members as well as disclosure obligations as per the Societies Act, it is difficult to maintain secrecy about the operations of a cooperative.

(iv) In return of the privileges offered by the government, cooperative societies have to comply with several rules and regulations related to auditing of accounts, submission of accounts, etc. Interference in the functioning of the cooperative organization through the control exercised by the state cooperative departments also negatively affects its freedom of operation.

(v) Differences of opinion: Internal quarrels arising as a result of contrary viewpoints may lead to difficulties in decision making. Personal interests may start to dominate the welfare motive and the benefit of other members may take a backseat if the personal gain is given preference by certain members.

### Types of Cooperative Societies:

(i) Consumer's cooperative societies:

The consumer cooperative societies are formed to protect the interests of consumers. The members comprise of consumers desirous of obtaining good quality products at reasonable prices.

The society aims at eliminating middlemen to achieve economy in operations

(ii) Producer's cooperative societies: These societies are set up to protect the interest of small producers. The society aims to fight against the big capitalists and enhance the bargaining power of the small producers. It supplies raw materials, equipment and other inputs to the members and also buys their output for sale. Profits among the members are generally distributed based on their contributions to the total pool of goods produced or sold by the society.

(iii) Marketing cooperative societies: Such societies are established to help small producers in selling their products. The members consist of producers who wish to obtain reasonable prices for their output. The society aims to eliminate middlemen and improve the competitive position of its members by securing a favorable market for the products.

(iv) Farmer's cooperative societies: These societies are established to protect the interests of farmers by providing better inputs at a reasonable cost. The members comprise farmers who wish to jointly take up farming activities. The aim is to gain the benefits of large scale farming and increase productivity. Such societies provide better quality seeds, fertilizers, machinery and other modern techniques for use in the cultivation of crops.

(v) Credit cooperative societies: Credit cooperative societies are established for providing easy credit on reasonable terms to the members. The members comprise of persons who seek financial help in the form of loans. Such societies aim to protect the members from the exploitation of lenders who charge high rates of interest on loans. Such

societies provide loans to members out of the amounts collected as capital and deposits from the members and charge low rates of interest.

(vi) Cooperative housing societies: Cooperative housing societies are established to help people with limited income to construct houses at reasonable costs. The members of these societies consist of people who are desirous of procuring residential accommodation at lower costs. The aim is to solve the housing problems of the members by constructing houses and giving the option of paying in instalments.

Q. 5 Distinguish between a Joint Hindu family business and partnership.

Answer:

The difference between a Joint Hindu family business and partnership are as follows:

S. No.	Basis of difference	Joint family	Partnership
1.	Governance	Governed by Hindu law	Governed by partnership act 1932
2.	Liability	The need of the family has unlimited liability while other members are limited to its share.	All the partners have unlimited liability.
3.	Decision making and control	The Karta is responsible for entire business and management.	All the members jointly manage the business.

4.	Numbers of members	There is no maximum limit of members	There is a certain limitation in the numbers of members involved. Minimum two and maximum 20 can only be involved.
5.	Minor	Minors can be members	Minors cannot be members.

Q. 6 Despite limitations of size and resources, many people continue to prefer sole proprietorship over other forms of organization? Why?

Answer:

There are many benefits of sole proprietorship over other forms of organization and for which prefer the most. Here are some of the benefits:

- a. There are hardly any legal formalities to be fulfilled by a sole proprietorship firm to set up. It can be started and close according to the wish of the owner.
- b. A sole proprietorship can alone take all the decision.
- c. A sole proprietorship is the recipient of all profits earned from business and this motivates others to operate a business.
- d. It is highly flexible in operation as it can adapt to any situation. This is possible because it involved only one person and he holds everything.

### **Application Questions**



Q. 1 In which form of organization is a trade agreement made by one owner binding on the others? Give reasons to support your answer.

Answer:

Partnership is a form of organization where a trade agreement made by one owner binding on the others. This is because of the Indian Partnership Act 1932 that stated, a business carried out by partners is acted equally by all. One member is the agent and thereby binds the other.

Q. 2 The business assets of an organization amount to Rs. 50,000 but the debts that remain unpaid are Rs. 80,000. What course of action can the creditors take if?

(a) The organization is a sole proprietorship firm

(b) The organization is a partnership firm with Anthony and Akbar as partners. Which of the two partners can the creditor's approach for repayment of the debt? Explain giving reasons

Answer:

(a) The sole proprietorship firm have unlimited liability. Partners are liable to repay debts even from their resources in case the business assets are not sufficient to meet its debts. Therefore, such actions can be taken by the creditors.

(b) In the given situation the creditor approach both of them as they are partners and liable to repay the debt jointly. If one of them is not available, then the other has to pay the debt and recover the amount later from the other partner.

Q. 3 Kiran is a sole proprietor. Over the past decade, her business has grown from operating a neighborhood corner shop selling accessories such as artificial jewellery, bags, hair clips and nail art to a retail chain with three branches in the city. Although she looks after the varied functions in all the branches, she is wondering whether she should form



accompany to better manage the business. She also has plans to open branches countrywide.

- (a) Explain two benefits of remaining a sole proprietor.
- (b) Explain two benefits of converting to a joint-stock company.
- (c) What role will her decision to go nationwide play in her choice of a form of the organization?
- (d) What legal formalities will she have to undergo to operate business as a company?

Answer:

- (a) Kiran can enjoy all the profits earned from the business as she is the sole proprietor and would have to share with anyone. She can quickly decide as it enjoys a considerable degree of freedom.
- (b) i. Capital can be attracted from the public as well as through loans from banks and financial institutions. Thus there is greater scope for expansion.  
ii. A company can afford to pay higher salaries to specialists and professionals. It can, therefore, employ people who are experts in their area of specializations
- (c) Her decision to go nationwide would involve an increase in her scale of operation, requirement of capital and management abilities. She will have to bear more risk as she is the sole proprietor and her liability will increase to a large extent.
- (d) To operate her business she has to go for certain legal formalities such as compulsory company registration, according to the Indian Companies Act 1956. The Legal formalities would once have to undergo to operate business as a company are –
  - 1. Submission of application in the prescribed form to the Registrar of firms. The application should contain the following particulars:

- Name of the firm
- Location of the firm
- Names of other places where the firm carries on business
- The date when each partner joined the firm
- Names and addresses of the Sole Proprietor
- Duration of partnership

2. Deposit of required fees with the Registrar of Firms.

3. The Registrar after approval will make an entry in the register of firms and will subsequently issue a certificate of registration.