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## **UNIT 2      FORMS OF BUSINESS ORGANISATION-I**

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### **2.0      OBJECTIVE**

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After studying this Unit, you should be able to:

- describe the various forms of business organisations
- outline the features of each form of business organisation
- explain the merits and limitation of each form of business organisation

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### **2.1      INTRODUCTION**

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In the pervious Unit you learnt that any activity carried with profit motive is called business and that such activity may be an industrial activity, a trading activity or a service activity like banking, insurance, transportation, etc. You have also learnt that bringing various resources together to set up a business and putting them to work systematically is termed as business organisation. The person who takes initiative to set up a business, provides the necessary funds and bears the risk involved is called the owner of business. When the business is organised on small scale, it may be possible for one person to provide the funds

and bear the risk. But when it is large, he may need others to join hands. Thus, business may be owned by an individual or a group of persons. When a business is owned and carried on by one person it is called 'Sole Trader Organisation'. But when it is owned by a group of persons it may take the form of partnership firm, a company or a cooperative society. In this Unit you will study in detail the features, classification, merits and limitations of these different forms of business organisations.

Look at Figure 2.1. It shows various forms of business organisation.

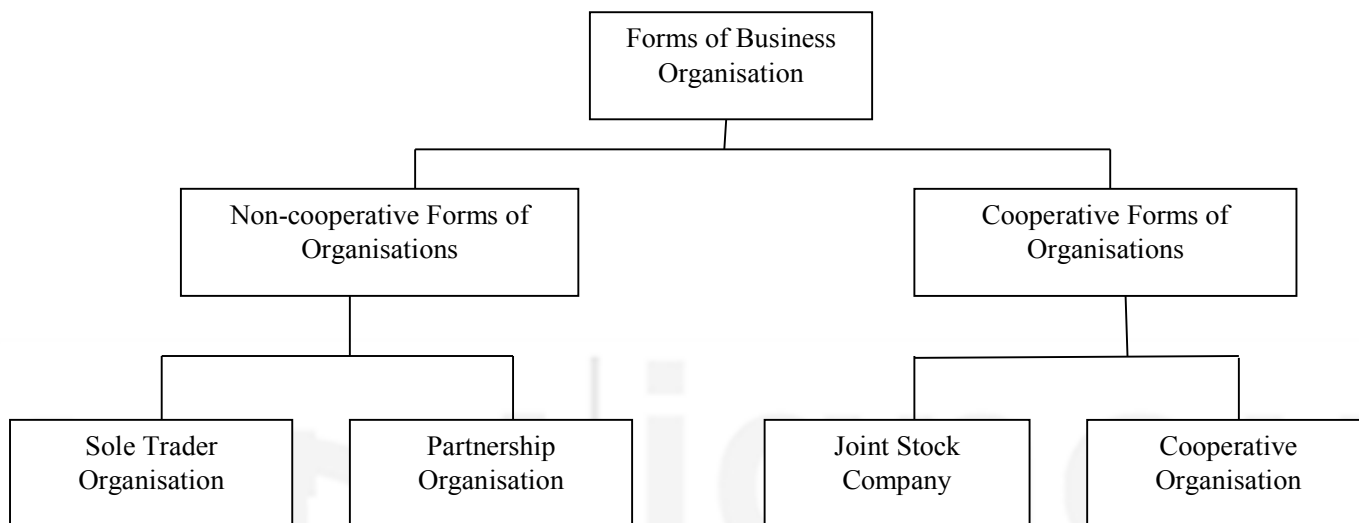


Figure 2.1: Various Forms of Business Organisations

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## 2.2 SOLE TRADER ORGANISATION

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The sole trader organisation (also called proprietorship) is the oldest form of organisation and the most common form of organisation for small business even today. It is the simplest and easiest to form. What is required is that an individual decides about the type of business to be started and arranges the necessary capital. Required capital may be mobilised from his own savings, or may be borrowed from friends and relatives. The business may be carried either in a portion of his own residence or in a rented building. The person generally manages the business on his own. He may also take the help of his family members or employ some persons, if necessary. He can take the advice from others in running the business, but his own will be the final decision. Thus, the sole trader enjoys full control over the affairs of the firm. He enjoys all the profits earned by the business. So in case of loss, naturally, he has to bear the full burnt of it.

Thus, we can now define sole trader organisation as “one man’s business in which an individual produces independently with his own capital, skill and intelligence and is entitled to receive all the profits and assumes all the risks of ownership”. J.L. Hanson defines it as “a type of business unit where one person is solely responsible for providing the capital for bearing the risk of the enterprise and for the management of the business”. Under this form of business organisation, no distinction is made between the business concern and the proprietor. Likewise, the management rests with the same person.

### 2.2.1 Main Features

Based on the above discussion, we can list the main features of sole trader organisation as follows.

- 1) **One man ownership:** The ownership lies with one person only. There are no associates or partners. He invests his own money or borrows from the friends and relatives.
- 2) **No separation of ownership and management:** The owner himself manages the business. Therefore, the separation of ownership and management which is quite common in big business is not present in this form of organisation. Since the proprietor himself manages the business, he exercises a high degree of supervision and control in the working of his business.
- 3) **No separate entity:** The business does not have an entity separate from the owner. The proprietor and the business enterprise are one and the same.
- 4) **All profits to proprietor:** Since there are no partners, all the profits are enjoyed by the sole proprietor.
- 5) **Individual risk:** All losses in the business are borne by the proprietor himself.
- 6) **Unlimited liability:** The proprietor has an unlimited liability. This means that in case of loss even the personal property of the owner can be utilised for clearing the business obligations and debts.
- 7) **Less legal formalities:** To set up sole proprietorship, no legal formalities are required. Of course, there are some legal restrictions for the setting up of a particular type of business. For example, an individual cannot start a bank or an insurance company. But one can start a fruit stall or a cycle shop without much legal formalities. However, in some cases a licence may be required. For example, to start a restaurant, you need licence from municipal corporation

### 2.2.2 Merits and Limitations

You have learnt about the main features of the sole-trade business. In view of these features, this form of organisation has the following merits and limitations.

#### Merits

- 1) **Easy formation:** There are no legal formalities to be observed while starting this form of organisation. Therefore, its formation is very easy and simple. The expenditure involved in the process of formation is also negligible.
- 2) **Direct motivation:** As you know, all the profits and gains of the business are solely and exclusively pocketed by the sole proprietor. This motivates the proprietor to work hard and develop the business to get more and more profits. His involvement in the business is, therefore, complete and free.
- 3) **Full control:** The proprietor is the monarch of the business he owns. He manages the whole business and takes all decisions himself. In other words,

proprietor exercises full control over the functioning and working of the business.

- 4) **Quick decision:** The proprietor does not depend on others for decision making. Since there are no partners, he is not required to consult others. This enables the proprietor to take quick decisions on numerous matters concerning his business.
- 5) **Flexibility in operations:** Being a small organisation it is easy to bring changes if situation so demands. In a large sized organisation to bring changes is difficult.
- 6) **Secrecy:** Since the whole business is handled by the proprietor his business secrets are known to him only. He is not bound to publish his accounts. Therefore, the degree of secrecy is the highest in this form of organisation.
- 7) **Personal touch:** When the proprietor handles everything relating to the business himself, it is easy to maintain a personal rapport with the customers. He can easily know their tastes, likes and dislikes and adjust his operations accordingly. Similarly, in this form of organisation, employees, if any, work directly under the proprietor. So, it gives scope for the proprietor to maintain harmonious relations with the employees.
- 8) **Dissolution easy:** Since there are no co-owners or partners, there is no scope for the difference of opinion in the case of dissolution of business. The proprietor is free to withdraw from the business or to sell it at any time he wants. Because of ease in formation and withdrawal, proprietorship form is often used to test business ideas.

### Limitations

- 1) **Limited resources:** The capital and other resources of an individual are always limited. The sole trader has to mainly rely on his own money and earnings, or he can borrow, if necessary, from relatives and friends. Thus, the proprietor has a limited capacity to raise funds. This makes it difficult to plan any large scale expansion.
- 2) **Limited managerial capability:** In the modern business, knowledge and skills in various fields like production, finance, marketing, etc., are required. It is not possible for a single individual to possess expertise in all these areas. So, his decisions may not be balanced.
- 3) **Not suitable for large scale operation:** Since the resources of the sole trader are limited, it is suitable only for small business and not for large scale operations.
- 4) **Unlimited liability:** You know that the proprietor has an unlimited liability. In case of a loss, even his personal property and belongings can be utilised for clearing business obligations. Therefore, he cannot take much risk and is discouraged from expansion of his business.
- 5) **Less stability:** The continuity and stability of the business depends solely on one person. When the man dies, there is a likelihood of closure of the business.

- 6) **No check and control:** As the sole trader is the monarch of the business, no outsider can question him on his acts and deals. There are no checks and controls on the sole trader.
- 7) **Less scope for economic of scale:** Sole trader usually operates on small scale only. So, he can not enjoy the benefits of large scale production or buying or selling. This may raise the cost of business operations.

### Check Your Progress A

- 1) Fill in the blanks.
- i) The liability of the sole trader is .....
  - ii) The whole profit of a sole trader organisation is pocketed by the .....
  - iii) Sole trade business organisation is suitable when the size of business is .....
  - iv) Number of owners in sole trader organisation is .....
  - v) In sole trader business, decision making is solely in the hands of .....
- 2) State whether the following statements are True or False.
- i) Sole proprietorship is most suitable for large scale business.  
True ☐ False ☐
  - ii) In sole trader organisation, the proprietor is not distinct from the business concern  
True ☐ False ☐
  - iii) Capital raising capacity of a sole proprietorship is unlimited.  
True ☐ False ☐
  - iv) In case of loss, the sole trader has to clear business obligations from his personal property.  
True ☐ False ☐
  - v) A sole proprietorship is owned by many persons but is managed by only one person.  
True ☐ False ☐

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## 2.3 PARTNERSHIP FORM OF ORGANISATION

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You have learnt that the sole trader organisations have limited financial resources, limited managerial ability and skills, and unlimited liability. In case of expansion more capital and more managerial skills are required. At the same time, the risk will also increase. A sole proprietor may not be able to fulfill all these requirements. A person who lacks managerial skills may be having capital. Another person who is a good manager may not be having sufficient capital. This calls for a situation where two or more persons come together, pool their capital and skills, and organise the business. This type of business organisation is called partnership organisation. It grew essentially because of the limitations and failure of the sole proprietorships.

As defined by J.L. Hanson, “a partnership is a form of business organisation in which two or more persons upto a maximum of twenty join together to undertake some form of business activity”.

The Indian Partnership Act, 1932 defined partnership as “the relation between persons who have agreed to share the profits of business carried on by all or any of them acting for all”.

The Uniform Partnership Act of the USA defines a partnership “as an association of two or more persons to carry on as co-owners a business for profit”.

Based on the above definitions, we can state that partnership is **an association of two or more persons who have joined together to share the profits of business carried on by all or any of them acting for all.**

The persons who own the partnership business are individually called ‘partners’ and collectively known as the ‘firm’ or ‘partnership firm’. On an agreed basis, partners contribute to capital and share the responsibility of running the business. However, in some cases one partner may provide the whole or major portion of the capital and others contribute technical and managerial skills with or without some capital. All such terms and conditions of partnership are usually mentioned in the partnership agreement.

### 2.3.1 Main Features

From the above discussion, we can list the main features of partnership form of organisation as follows :

- 1) **Plurality of persons;** To form a partnership firm, there should be at least two persons. The maximum limit on the number of persons is ten for banking business and twenty for other types of business
- 2) **Contractual relationship:** Partnership is created by an agreement between persons called ‘partners’. In other words, a person can become a partner only on the basis of a contract. This contract could be oral, written or implied.
- 3) **Profit sharing:** There must be an agreement among the partners to share the profits and losses of the business of the partnership firm. This is one of the basic elements of partnership. If two or more persons jointly own some property and share its income, it is not regarded as partnership.
- 4) **Existence of business:** The purpose of the agreement among the partners is to do some lawful business and share profits. If the purpose is something other than business, it should not be treated as partnership. For example, if the purpose is to carry some charitable work, it will not be treated as partnership.
- 5) **Principal-agent relationship:** The business of the firm may be carried on by all or one or more partners acting for all the partners. Every partner is entitled to take part in the operations of the firm. In dealing with other parties, each partner is entitled to represent the firm and other partners in respect of the business of the firm. All partners are bound by his acts done in the ordinary course of business and in firm’s name. In this sense a partner is agent of the firm and the other partners.
- 6) **Unlimited liability:** In respect of business debts, each partner has unlimited liability. This means that if the assets of the firms are not sufficient to meet the obligations of the firm, the partners have to pay from their private assets.



The creditors can even realise the whole of their dues from one of the partners. Thus, all the partners are jointly and severally liable for all business debts and obligations.

- 7) **Good faith and honesty:** A partnership agreement rests on good faith among the partners. The partners must be honest to each other and trust each other. They must disclose every information about the business and present true accounts to one another.
- 8) **Restriction on transfer of share:** A partner cannot transfer his share to an outsider without the consent of all the other partners.

### 2.3.2 Classification of Partners

You have learnt that different partners play different roles in the operations of the firm. One partner may contribute more capital while another partner may spend more time in managing it. Depending on the role played, we can classify the partners into various categories. Look at Figure 2.2 for the classification of partners.

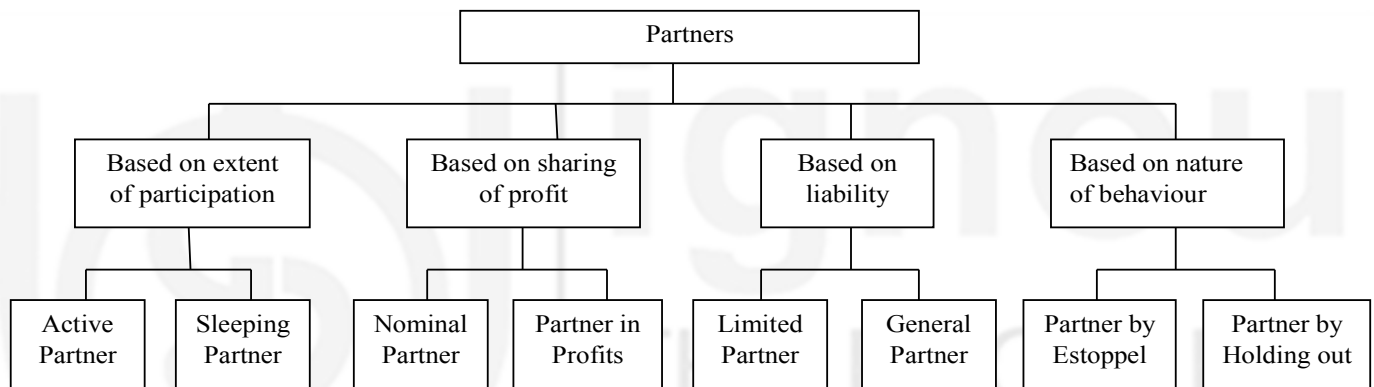


Fig. 2.2: Classification of Partners

**Based on the extent of participation** in the functioning of the business, we can classify partners into: (a) active partners, and (b) sleeping partners.

- a) **Active partner:** If a partner takes an active part in the management of the business, we call him as active partner. He is also known as a ‘working partner’.
- b) **Sleeping partner:** If the partner is not actively associated with the working of the partnership firm, we call him a sleeping partner. A sleeping business partner simply invests his capital. He does not participate in the functioning of the firm. Such, a partner is also known as a ‘dormant partner’.

**Based on the sharing of profits,** partners may be classified into: (a) nominal partners, and (b) partner in profits.

- a) **Nominal partner:** A partner who just lends his name to the partnership is known as a nominal partner. He neither invests his capital nor participates in the day-to-day working and management of the firm. Such partners are not entitled to a share of profits, but they are liable to other parties for all the acts of the firm.

- b) **Partner in profits:** A partner who shares the profits of the business without being liable for losses is called a partner in profits. As a rule, he will not take any part in the management of the business. This is applicable to a minor who is admitted to the benefits of the firm.

**Based on the behaviour and conduct exhibited**, the partners may be divided into: (a) partner by estoppel, and (b) partner by holding out.

- a) **Partner by estoppel:** A person who behaves in the public in such a fashion as to give an impression that he is one of the partners in a partnership firm is called a partner by estoppel. Such partners are not entitled to profits but are fully liable as regards the firm's obligations.
- b) **Partners by holding out:** If a particular partner of a firm represents that another person is also a partner of the firm, and if such a person does not disclaim the partnership relationship even after coming to know about it, such person is called a 'partner by holding out'. Such partners are not entitled to profits but are liable as regards the obligations of the firm.

You should note the difference between these two types clearly. In the case of a partner by estoppel, the person's own behaviour and conduct have created a mistaken impression in the third parties mind that he is a partner of the firm. Whereas in the case of a partner by holding out, the other partners have represented the person as a partner, though he is not one, and he does not contradict it.

**Based on liabilities** also, partners may be classified into two categories: (a) limited partners, and (b) general partners.

- a) **Limited partner:** The liability of such a partner is limited to the extent of the capital contributed by him. He is not entitled to take part in the management of the business, but he can advise the other general members. His acts do not bind the firm. He has right to inspect the books of the firm for his information. Such partners are also called 'special partners'.
- b) **General partner:** He is also called 'unlimited partner'. His liability is unlimited and he is entitled to participate in the management of the business. Every partner who is not a limited partner is treated as a general partner.

As know in partnership the liability of the partners is unlimited. The limited partners are found only in limited partnership form of organisation which is found only in some European countries like the USA. **This is not allowed in India.**

### 2.3.3 Partnership Deed

You know that a partnership is formed by an agreement. Such agreement may be either written or oral. To avoid misunderstanding and unnecessary litigations, it is always desirable to have a written agreement. When the written agreement is duly stamped and registered, it is known as 'Partnership Deed'. After registration, each partner is given a copy of the partnership deed, A partnership deed, generally contains the following particulars.



- 1) Name of the firm.
- 2) Nature of the business to be carried out.
- 3) Names of the partners.
- 4) The town and the place where business will be carried on.
- 5) The amount of capital to be contributed by each partner.
- 6) The profit and loss sharing ratio of each partner.
- 7) Loans and advances by partners and the interest payable on them.
- 8) The amount of drawings by each partner and the rate of interest allowed thereon.
- 9) The rate of interest on capital.
- 10) Duties, powers, and obligations of partners.
- 11) Remuneration, if any, payable to the active partner.
- 12) Maintenance of accounts and arrangements for audit.
- 13) Settlement in the case of dissolution of partnership.
- 14) The methods of evaluation of goodwill on admission or death or retirement of a partner.
- 15) The method of revaluation of assets and liabilities on admission or death or retirement of a partner.
- 16) The method of retirement of a partner and the arrangement for the payment of the dues of a retired or decreased partner.
- 17) Arbitration in case of disputes among partners.
- 18) Arrangements in case a partner becomes insolvent.

This is not an exhaustive list. Any other clauses, as desired by the partners, could be included in the partnership deed. In fact, the Partnership Act defines certain rights and duties of a partner. But the provisions of the Act come into operation only when there is no agreement amongst the partners.

**Registration of the firm:** Under the Indian Partnership Act it is not compulsory to register the firm. But there are certain limitations for an unregistered firm. So it is better to register it. Registration can be done at any time. To register the firm, an application with all particulars about the firm and registration fee has to be sent to the Registrar of Firms.

### 2.3.4 Merits and Limitations

You have learnt about the main features of partnership. This would help you to identify the merits and limitations of this form of organisation which are as follows:

#### Merits

- 1) **Easy formation:** Although the formation of a partnership firm is not as easy as the sole proprietorship, but it is much less difficult as compared to a company. The partners agree to do business together and draw up and sign the partnership agreement. After that there are no complex government laws regulating the establishment of the partnership.

- 2) **More capital available:** Unlike sole proprietorship, there are two or more partners in partnership firms. So a partnership firm does not have to rely on a single individual as the source of its funds. The added financial strength of the partners increases the borrowing capacity of the firm
- 3) **More diverse skills and expertise:** The partnership involves more people in decision making because there are more owners. An ideal partnership brings together partners who complement each other, not partners who have the same background and experience. One partner might be a specialist in manufacturing, another in marketing, and the third partner might be an accountant. Combined judgment of all these partners often leads to better decisions than otherwise.
- 4) **Flexibility:** Like sole proprietorship, the partnership business is also owned and run by the partners themselves. They can easily appreciate and quickly respond to the changing conditions.
- 5) **Secrecy:** In partnership firms, some secrecy can be maintained because there is no obligation to publish accounts of the firm.
- 6) **Keen interest:** Since partners are liable to losses and risks of a business they take keen interest in the affairs of the business.
- 7) **Protection:** Due to the rule of unanimity in fundamental matters, the rights of all partners are fully protected. If a partner is dissatisfied with the working of firm, he can ask for dissolution of the firm and withdraw from the business.
- 8) **Checks and controls over careless decisions:** Since the partnership is run on collective basis and all partners participate in major decisions, there is lesser scope for reckless and hasty decisions.
- 9) **Diffusion of risk:** The losses of the firm will be shared by all the partners. Hence, the share of loss in the case of each partner will be less than that sustained in sole proprietorship.

### Limitations

- 1) **Limited capital:** Since there is a limit of maximum partners (20 in non-banking firms and 10 in banking firms), the capital raising capacity of the partnership firms is limited as compared to a joint stock company.
- 2) **Unlimited liability:** The most important drawback of a partnership firm is that the liability of the partners is unlimited.
- 3) **No public confidence:** Since the accounts are not published and publicized, the firm may not be able to command confidence of the public.
- 4) **Non-transferability of interest:** No partner can transfer his interest in a firm without the consent of other partners.
- 5) **Uncertainty:** The sudden death, lunacy or insolvency of a partner leads to the dissolution of partnership. This breeds uncertainty in the continuity of a partnership firm. However, this could be partly avoided if such matters are specified in the partnership agreement.

- 6) **Conflicts among partners:** There is scope for misunderstanding and conflicts among the partners. This may cause delays in decision making and may lead even to dissolution of the firm. To some extent, this problem could be avoided if the partnership agreement is clear and detailed.
- 7) **Risk of implied authority:** Since each partner acts as an agent of the firm, acts of one partner would bind the firm and all the remaining partners. A dishonest or incompetent partner may lend the firm into difficulties and the other partners may have to pay for it.

### Check Your Progress B

- 1) Fill in the blanks.
- i) The maximum number of partners in a partnership firm doing banking business is .....
  - ii) Liability of partners in a partnership firm is .....
  - iii) A partner who is not participating in the management of the firm is called ..... partner.
  - iv) The minimum number of members in a partnership firm is.....
  - v) A registered partnership agreement is called .....
  - vi) A person's own behaviour has created the impression that he is one of the partners of a partnership firm. Such partner is called .....
  - vi) If the liability of the partner is limited to the capital contributed by him, such a partner is called .....
- 2) State whether the following statements are True or False.
- i) Partnership agreement must be in writing. True ☐ False ☐
  - ii) There is no maximum limit for membership in a partnership organisation. True ☐ False ☐
  - iii) Members of a partnership firm are called partners. True ☐ False ☐
  - iv) A partner can transfer his share to some other person without the consent of the other partners. True ☐ False ☐
  - v) Every partner is a proprietor of the firm and also an agent of the firm. True ☐ False ☐
  - vi) A sleeping partner actively participates in the working of the firm. True ☐ False ☐
  - vii) A person who is a partner by holding out is entitled to share the profits. True ☐ False ☐
  - viii) The acts of one partner would bind the firm and the remaining partners. True ☐ False ☐

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## 2.4 JOINT HINDU FAMILY FIRM

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Joint Hindu Family firm is a unique form of business organisation prevailing only in India. This is the firm belonging to joint Hindu family and governed by the provisions of the Hindu Law.

In Hindu Law there are two schools:

- a) **Mitakshara:** It is applicable to the whole of India except Bengal and Assam. According to this school, a Hindu inherits property from his father, grand father, and great grand father. Thus, three successive generations in the male line (son, grandson, and great grandson) inherit the ancestral property. They are called coparceners and the senior most member of the family is called 'Karta'. The Hindu Succession Act, 1956 has extended the line of coparcenary interest to female relatives of the deceased coparcener or male relatives claiming through such female relatives.
- b) **Dayabhaga:** It is applicable in Bengal and Assam. According to this, the male heirs become members only on the death of the father.

According to Hindu Law, a business is an inheritable asset. After the death of Karta, the business will be jointly owned by all the coparceners. The elder person among the coparceners becomes the new Karta and manages the business. If any property is inherited from any other relative, or acquired from personal resources, such property is regarded as personal property and treated as distinct from ancestral property.

Important features of the Joint Hindu Family Firm are:

- 1) Business is managed by the senior member of the family called Karta. Other members do not have the right to participate in the management of the firm.
- 2) Other members cannot question the authority of the Karta. Their only remedy is to get the family dissolved by mutual agreement.
- 3) Karta has the power to borrow funds for the business. The liability of the Karta is unlimited whereas the other coparceners are liable only to the extent of their share in the business.
- 4) If the Karta has misappropriated the funds of the business, he has to compensate the other coparceners to the extent of their shares in the joint property.
- 5) The death of any member of the family does not dissolve the business or the family.
- 6) Through mutual agreement the joint Hindu family firm can be dissolved.

You should note the difference between the joint Hindu family firm and the partnership firm. A joint Hindu family firm is the result of the operation of the Hindu Law. No formal agreement is required to convert a business into a joint Hindu family business. The members of the family automatically become coparceners. Only the Karta can participate in the management. The liability of the Karta is unlimited but the liability of the other coparceners is limited to their shares in the business. The rights, duties and liabilities of coparceners are

governed by the provisions of the Hindu Law. Partnership is the result of an agreement between the persons who need not be blood relatives. Each partner has the right to participate in the management of the business. The liability of each partner is unlimited. The duties, rights and liabilities of the partners are governed by the Indian Partnership Act, 1932.

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## **2.5 COMPANY FORM OF ORGANISATION**

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You have learnt that sole proprietorships and partnerships have the disadvantages of limited resources, unlimited liability, limited managerial skills, etc. The life and stability of these organisations also depend on the life and stability of the proprietors/partners. Hence, they are not considered suitable for large scale business.

For large scale business, you require large investment and specialised managerial skills. The element of risk is also very high. This situation led to the emergence of company form of business organisation. In case of joint stock company, capital is contributed by not one or two persons but by a number of persons called shareholders. Thus, it is possible to raise large amount of capital. A joint stock company is an association of persons registered under Companies Act for carrying on some business. It is called an artificial person as it is created by law, with a distinctive name, a common seal and perpetual succession of members. It can sue and be sued in its own name. The most widely quoted definition of a company (called Corporation in USA) is the one given by Chief Justice Marshall. According to him “a corporation is an artificial being, invisible, intangible and existing only in contemplation of law. Being the mere creature of law, it possesses only those properties which the charter of its creation confers upon it, either expressly or an incidental to its very existence”. Lord Justice Lindley has defined it as “an association of many persons, who contribute money or money’s worth to a common stock and employ it for a common purpose. The common stock so contributed is denoted in money and is the capital of the company. The persons who contribute it or to whom it belongs are members. The proportion of capital to which each member is entitled is his share”.

The Indian Companies Act (1956) defines joint stock company as “a company limited by shares having a permanent paid up or nominal share capital of fixed amount divided into shares, also of fixed amount, held and transferable as stock and formed on the principles of having in its members only the holders of those shares or stocks and no other persons”.

In a joint stock company, the shareholders are the real owners of the company. Their liability is limited. They can also transfer their shares to others. Since the shareholders are very large in number, the company cannot be managed by all. They elect a board of directors to manage the company. The destiny of the company is guided and directed by the directors. These directors employ some people to carry on the day-to-day business of the company. The company can raise additional funds by issuing debentures (also called bonds). You will learn about the company form of organisation, its main features, classification and formation in detail in Block II (Unit 5-9). Here we list the merits and limitations of the company form of organisation.

## 2.5.1 Merits and Limitations

The company form of organisation has been popular and successful in almost all the countries. This form is suitable where large resources are required and the production has to be carried out on a large scale. The number of joint stock companies has shown a phenomenal increase in the twentieth century. Let us now discuss the merits and limitations of the company form of organisation.

### Merits

- 1) **Large capital:** Since company forms of organisation are allowed to have a large number of shareholders, it is possible to raise capital in large amounts. Whenever new capital is required, it can issue shares and debentures. For this reason, only the company form of organisation is best suited.
- 2) **Limited liability:** The liability of shareholders, unless and otherwise stated, is limited to the face value of the shares held by them or guarantee given by them. Their private property is not attachable to recover the dues of the company. Thus, this form of organisation is a great attraction to persons who are not willing to take risk as is inherent in sole proprietorship and partnership.
- 3) **Stability of existence:** A company has a separate legal entity with perpetual succession. The Corporation is not affected by lunacy or insolvency of a shareholder, director or officer. The continuity of the company is desirable in the interest of not only its members but also the society.
- 4) **Economies of scale:** As companies operate on a large scale, they can take advantage of large scale buying, selling, production, etc. As a result of these economies of large scale operations, companies can provide goods to consumers at a cheaper price.
- 5) **Scope for expansion:** As there is no limit to the maximum number of shareholders in a public limited company, expansion of business is easy by issuing new shares and debentures. Companies normally keep part of their profits as reserve and use them for expansion.
- 6) **Public confidence:** Companies are subject to Government controls and regulations. Their accounts are audited by a chartered accountant and are to be published. This creates confidence in the public about the functioning of the company.
- 7) **Transferability of shares:** The shares of the public limited company can be sold at any time in the stock exchange. Shareholders can sell their shares whenever they want. There is no need to take the consent of other shareholders. Thus, shareholders can convert their shares into cash at any time without much difficulty.
- 8) **Professional management:** You know that the management of a company is in the hands of the directors who are elected by shareholders. Normally, experienced persons are elected as directors. You also know that day-to-day activities are managed by salaried managers. These managers are the experts in their respective fields. As companies have large scale operations and profits, attracting good professional managers are easy by paying



attractive salaries. Thus, company form of organisation gets the services of professionals on the Board of Directors and in various management positions.

- 9) **Tax benefits:** Companies pay income tax at flat rates. There is no provision for slab system in the taxation of companies. As a result, companies pay lower taxes on higher incomes compared to other forms of organisations. Companies also get some tax concessions if they are established in backward areas.
- 10) **Risk diffused:** As the membership is very large, the business risk is divided among the several members of the company. This is an advantage for small investors.

### Limitations

- 1) **Difficulty in formation:** Promotion of a company is not as simple as proprietorships and partnerships. A number of persons known as promoters should be ready to associate themselves with it for getting a company incorporated. A lot of legal formalities are to be performed at the time of registration. Promotion of a company is expensive as well as complicated.
- 2) **Lack of secrecy:** The management of companies is usually in the hands of many persons. Everything is discussed in the meetings of Board of Directors. Therefore, compared to sole trader and partnership concerns, maintaining business secrets is relatively difficult in a company form of organisation.
- 3) **Delay in decision making:** In company form of organisation all important decisions are taken by either the Board of Directors or shareholders in their meetings. Hence, decision making process is time consuming. If a quick decision is needed it will be difficult to arrange meetings all of a sudden. So, some business opportunities may be lost because of delay in decision making.
- 4) **Neglect of minority interest:** The representatives of the majority group of shareholders become the members in the Board of Directors. The shareholders who are in minority never get representation on the Board of Directors. As a consequence, the interests of the minority members may be neglected and oppressed at the hands of the majority group.
- 5) **Concentration of economic power:** The company form of organisation gives scope for concentration of economic power in a few hands. Some persons become directors in a number of companies and formulate policies to promote their personal interests. The shares of a number of other companies are purchased to create subsidiary companies. Establishment of subsidiary companies and interlocking of directorships have facilitated concentration of economic power in the hands of a few business houses.
- 6) **Lack of personal interest:** In sole proprietorship and partnership firms, business is managed by owners themselves. In company form of organisation, day-to day management is vested with the salaried executives who do not have any personal interest in the company. This may lead to reduced employee motivation and result in inefficiency.

- 7) **More government restrictions:** A company is subject to many restrictions from which the proprietorships and partnerships are exempted. So, it has to spend considerable time and effort in complying with the various legal requirements.
- 8) **Fraudulent management:** There is a possibility that some unscrupulous promoters may float a bogus company, issue shares and collect money. Later on they can get away with the money by putting the company in liquidation. It is also possible that the directors and professional managers may misuse the company resources for their personal benefit and bring losses to the company

### Check Your Progress C

- 1) State whether the following statements are True or False
- i) In the case of companies, shareholders cannot transfer their shares to others. True ☐ False ☐
  - ii) A company is a legal person created by law True ☐ False ☐
  - iii) A company form of organisation is not suitable for large scale business True ☐ False ☐
  - iv) Compared to sole proprietorship and partnership, companies can avail the benefits of economies of large scale True ☐ False ☐
  - v) Company can not buy property on its own name True ☐ False ☐
  - vi) There are less legal formalities to start a company True ☐ False ☐
  - viii) Company is separate from its owners and it has an entity of its own True ☐ False ☐
  - ix) A company has to be closed if the majority of the shareholders are dead. True ☐ False ☐

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## 2.6 COOPERATIVE FORM OF ORGANISATION

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Cooperative organisations are generally started by the poor and the economically weak sections to promote their common economic interests through business propositions. The basic philosophy of cooperative organisation is self-help and mutual help. The primary objective of any cooperative organisation is to render service to its members. In this respect, it is different from the other three forms of organisations which are primarily meant for making profits. The important features of the cooperative organisation are service in place of profit, mutual help in place of competition, self-help in place of dependence, and moral solidarity in place of unethical business practices.

As defined by International Labour Office “Cooperative organisation is an association of persons, usually of limited means, who have voluntarily joined together to achieve a common economic end through the formation of a democratically controlled business organisation, making equitable contributions to capital required and accepting a fair share of risks and benefits of the undertaking.”

Calvert has defined cooperation as a “a form of organisation wherein persons voluntarily associate together as human beings on the basis of equality for the promotion of the economic interests of themselves.”

The Indian Cooperation Societies Act, 1912, Section 4, defined it as “a society which has as its objectives the promotion of economic interests of its members in accordance with cooperative principles.”

Based on these definitions we can state that the cooperative organisation is a ‘voluntary’ association of persons who are not financially strong and cannot stand on their own legs. They come together not with a view to get profits but to overcome disability arising out of the want of adequate financial resources. The basic objective of such an organisation is self-help and mutual help.

Cooperative organisations are to be registered with the Registrar of Cooperative Societies of the concerned state in which the society’s registered office is situated. There should be minimum of 10 members to form a cooperative. But there is no maximum limit for membership.

Like the company form of organisation, the members of the society are the owners. They contribute the required capital and get a share in the profit, which is known as dividend. The liability of the members is limited.

Management is vested in the hands of the managing committee which is elected by the members in the annual general meeting.

### 2.6.1 Main Features

Based on the above discussion we can identify the following distinctive features of cooperative organisations.

- 1) **Voluntary association:** As stated above, persons desirous of pursuing a common objective can form themselves into an association and leave the same as and when one likes. This has two important connotations:
  - a) Any person can become a member irrespective of his caste, creed, religion, colour, sex, etc.
  - b) The members come together to form themselves into an association without any coercion or intimidation.
- 2) **Autonomy and stability:** Within the limits set by the constitution, the general law and its charter, a cooperative society is a self governing organisation. It is self-sufficient, self-renewing, and self-controlling within its jurisdiction. Like a company, a cooperative organisation also enjoys a separate and independent entity distinct from that of its members. As such, it has a perpetual life and is not affected by the entry and exit of members.
- 3) **Democratic management:** The management of cooperative organisation vests in a managing committee elected by members on the basis of ‘one member-one vote’ irrespective of the number of shares held by any member. It is the general body of the members which lays down the broad framework of policy within which the managing committee has to function. Democracy is, thus, the keynote of the management of a cooperative society.

- 4) **Capital:** The capital is procured from its members in the form of share capital. However, the share capital constitutes only a limited source of business finance. The major part is raised either by way of loan from the government and the apex cooperative institutions, or by way of grants and assistance from the central or state governments.
- 5) **Government control:** In India, all cooperative societies are registered under Cooperative Societies Act, 1919 or other State Cooperative Societies Act. Cooperative societies are subjected to detailed regulation under these Acts.
- 6) **Service motive:** The primary objective of any cooperative society is to provide service to its members. As you know, in the case of the other three forms of organisations the primary objective is to earn profits.
- 7) **Limited return on capital:** In cooperative system, profits are distributed among the shareholders for the capital they have contributed. But the rate of dividend paid to the shareholders is limited to 9% as per the Cooperative Societies Act.
- 8) **Distribution of surplus:** In case of a partnership firm and a company, profits are distributed among the members in the ratio of the capital contributed by each of them. In case of cooperative societies, after giving a limited dividend to shareholders, the surplus profits are distributed in the form of bonus. This bonus is not in the proportion of the share capital, but in the proportion of the business they have done with the society. For example, in case of a consumer cooperative society, bonus is paid in the proportion of the purchases made by the members from the society. Similarly, in case of a producer's society, bonus is paid in the proportion of the goods delivered for sale to the society.

### 2.6.2 Classification of Cooperatives

Cooperatives were started in different fields to promote the well being of different section of the society. Therefore there are different types of cooperative societies. The important types are given below.

- 1) **Consumer cooperatives:** People who want to obtain their day-to-day household good at reasonable prices form consumer cooperative societies. The main objective of these societies is to protect the members from the evils of unfair trade and the steep rise in prices. These societies purchase goods in bulk from wholesalers or producers and sell them to its members, sometimes also to non-members.
- 2) **Producer's cooperatives:** These are the societies formed by the small industrial producers and artisans. They are also called industrial cooperatives. The main objective is to protect the small producers and workers from exploitation. They provide credit facility, supply raw-materials, market the products produced by members, and help the members to buy machinery on hire purchase.
- 3) **Marketing cooperatives:** When the producers form into a cooperative society for the purpose of arranging the sale of their output, it is called marketing cooperative. These societies are started in order to protect

producers from exploitation by the middlemen when they market their products.

- 4) **Housing cooperatives:** These societies mainly operate in urban areas. They are mainly formed to provide housing facility to its members. The housing societies acquire land, plan the lay out and construct houses, and later allot them to the members. Some of them simply develop the land and allot plots to its members who then construct houses on their own. The society helps in arranging loans for them.
- 5) **Credit cooperatives:** Credit societies are started by persons who are in need of credit. Such societies provide credit to their members at a reasonable rate of interest. These credit societies may be classified into agricultural credit societies and non-agricultural credit societies. Agricultural credit societies are started to provide loans to farmers to meet the expenses in cultivation. These societies may be further classified into two groups: i) societies which provide short term and medium term credit, and ii) societies which are concerned with long term credit.

Non-agricultural credit societies are formed by the employees of industrial units and various institutions. They can also be organised by small traders, artisans and people of low income groups in towns and cities to meet their credit requirements. Under this category there are cooperative urban banks, thrift societies, employees credit society, industrial cooperative banks, house mortgage banks, etc.

- 6) **Farming cooperatives:** Economies of large scale operations cannot be derived by small farmers. Therefore, small farmers form into a cooperative society, carry on the work jointly and share the returns. These societies are most helpful to small and marginal farmers and enable them to get the advantages of large scale operations. They may form a cooperative better farming society, a cooperative tenant farming society, a cooperative joint farming society, a cooperative collective farming society, etc.

In addition to the cooperatives described above, there are many other types of cooperative because the principle of cooperation is extended to a large number of activities and operations. There are cooperatives such as processing cooperatives, construction cooperatives, transport cooperatives, auto rickshaw cooperatives, washer men cooperatives, fishery cooperatives, dairy cooperatives, sugarcane growers cooperatives, oilseeds growers cooperatives, etc. The aim of all these societies is to promote the welfare of their members.

### 2.6.3 Merits and Limitations

Different types of cooperatives have distinct merits and limitations. But there are some common merits and limitations which can be traced to all types of cooperative societies.

#### Merits

- 1) **Easy formation:** Formation of a cooperative society is easy as compared to the formation of a company. Cooperative society is a voluntary association and so it does not require long and complicated legal formalities at the time



of formation. Any 10 adult persons can voluntarily form themselves into an association and get it registered with the Registrar of Cooperatives.

- 2) **Limited liability:** Like company form of organisation, liability of members is limited in cooperative societies also.
- 3) **Social services:** Cooperatives foster fellow feeling among members and impart moral and educative values in their everyday life which are essential for better living.
- 4) **State assistance:** Cooperatives have been adopted by the government as an instrument of economic policy. So, a number of grants, loans and financial assistance are offered by the government to these societies to make them function effectively.
- 5) **Open membership:** The membership of cooperative societies is open to everybody. Nobody is debarred from joining on the basis of economic position, caste, colour or creed. There is no limit on the maximum number.
- 6) **Supply of goods at cheaper rates:** The societies purchase goods directly from producers and sell them to the members at cheap rates. The middlemen are eliminated from the channel of distribution. The consumer cooperatives supply essential goods to the members at a time when there is scarcity of goods in the market. Even capital goods (like machinery, etc.) are procured directly from producers and are supplied to the members. So cooperative societies ensure regular supply of goods at cheaper rates.

### Limitations

- 1) **Lack of business acumen:** Members normally do not have business experience. As a consequence, when they become the members of the Board of Directors, the society is not conducted efficiently. Unlike companies, cooperatives cannot employ outside talents and trained personnel for improving the management competency. This is because such steps are incompatible with their avowed ends and limited means.
- 2) **Absence of mutual interest:** A cooperative can only succeed when the members are imbued with a spirit of cooperation. Unfortunately, some influential members use the cooperative society as a source of their personal gains.
- 3) **Lack of interest:** Sustained efforts over a period are the prerequisites for success in any business. But such a state of affairs does not exist in many cooperatives. Within a short period of its dramatic start, the cooperative becomes lifeless and inactive in its operation.
- 4) **Lack of coordination:** It cannot be denied that internal dissensions and rivalries among the members sap much of its strength and vigour. The absence of coordinated and joint action is responsible for the collapse of many cooperative associations.
- 5) **Corruption:** One of the most important drawbacks of a cooperative form of organisation is the prevalence of corrupt practices in the management and functioning of the cooperative societies.



- 6) **Lack of secrecy:** The affairs of cooperatives are generally exposed to the members and it becomes quite difficult for them to maintain secrecy in business affairs.
- 7) **Insufficient motivation:** Since the rate of return on capital is low, the members do not feel involved in the affairs of the society.

### Check Your Progress D

- 1) State whether the following statements are True or False.
- i) Earning profit is the primary objective of cooperative organisation.  
True ☐ False ☐
  - ii) Management of cooperatives is completely in the hands of the government.  
True ☐ False ☐
  - iii) Cooperative society is incorporated under the Indian Companies Act. 1956  
True ☐ False ☐
  - iv) In cooperatives each member is entitled to receive the bonus in the proportion of the business he has done with the society.  
True ☐ False ☐
  - v) Women cannot become members of a cooperative society.  
True ☐ False ☐
- 2) Fill in the blanks.
- i) In cooperative societies, liability of the members is .....
  - ii) To form a cooperative, there should be at least ..... members.
  - iii) The maximum number in a cooperative society is .....
  - iv) Primary motive of cooperative is .....
  - v) Maximum rate of dividend that can be paid to the members on share capital in a cooperative society is .....

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## 2.7 LET US SUM UP

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Based on ownership there are four basic forms of business organisation: 1) sole trader organisation, 2) partnership organisation, 3) company organisation, and 4) cooperative organisation.

A business which is owned, financed and controlled by a single person is called sole trader organisation. This is most suitable for small business. There is no distinction between the business concern and the proprietor. This form of organisation has advantages from the point of view of control, secrecy, ease and low cost of formation, ease of dissolution and less government regulations. Disadvantages include the owner's unlimited liability, difficulty in raising capital, limited management expertise, unstable business life and difficulty in attracting qualified employees.

A partnership is an association of two or more persons to carry on as co-owners of a business for profit. Usually there would be a written or oral agreement

between partners which specifies the contribution of each partner to the business, the partner's roles, and other major points of agreement. There are various types of partners based on: (a) extent of participation, (b) profit sharing, (c) behavior and conduct exhibited, and (d) liability shared. Partnership organisation can overcome some of the disadvantages of sole proprietorship organisations. Advantages of partnership include capital, more specialised management, more certainty, greater incentives to key employees, etc. Partnerships suffer from unlimited liability, difficulty in transferring the shares, potential owner conflicts, short length of life, etc.

Limitations of sole proprietorships and partnerships gave rise to company form of organisation. A company is an artificial person created by law, with a distinctive name, a common seal and perpetual succession. Major advantages of company form of organisation include shareholders' limited liability, transferability of shares, stability of existence, ease of obtaining additional capital, more managerial expertise, etc. Major limitations are cost and difficulty of formation, more government regulations, lack of secrecy, less scope of prompt decision making, etc.

Cooperative form of organisation is a voluntary association of persons who are not financially strong and cannot stand on their own legs. They come together not with a view to get profits, but to overcome the instability arising out of want of adequate financial resources. The underlying objective is self-help and mutual help. Advantages of cooperative form of organisation include easy formation limited liability, government assistance, open membership, etc. Disadvantages include lack of business acumen, absence of mutual interest, lack of secrecy, rivalry among members, etc.

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## 2.8 KEY WORDS

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**Active Partner:** A partner who takes an active part in the operations of the partnership business.

**Company:** An association of persons registered under the Companies Act. It is an artificial person created by law, with a distinctive name, a common seal and perpetual succession of its members.

**Cooperative Organisation:** A voluntary association of persons established under the Cooperative Societies Act.

**General Partner:** A partner of a partnership organisation whose liability is unlimited and also entitled to participate in the management of the business.

**Limited Partner:** A partner whose liability is limited to the extent of the capital contributed by him.

**Joint Hindu Family Firm:** A business firm owned by a joint Hindu family.

**Nominal Partner:** A partner who just lends his name to the partnership firm. He neither invests his capital nor participates in the management.

**Partner:** A person who is the member in a partnership firm.

**Partner by Estoppel:** A person whose conduct and behaviour creates an impression that he is a partner in the partnership firm.

**Partner in Profits:** A partner who shares the profits of the business without being liable for losses.

**Partnership Agreement:** A written or oral agreement entered into by partners specifying the constitution rules and regulations of the partnership.

**Partnership Deed:** A written partnership agreement which is duly stamped and registered.

**Partnership Organisation:** An association of two or more person, who join together to share the profits of business carried on by all or any of them acting for all.

**Sleeping Partner:** A partner in a partnership firm who is not actively associated with the working of the firm.

**Sole Trader Organisation:** One man business in which an individual produces independently with his own capital, skill and intelligence and is entitled to receive all the profits and assume all risks of ownership.

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## 2.9 SOME USEFUL BOOKS

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Bhushan, Y.K. 1987, *Fundamentals of Business Organisation & Management*, Sultan C & Sons: New Delhi. (Part Two, Chapters 1, 2 & 3)

Musselman, V.A., and J.H. Jackson, 1985, *Introduction to Modern Business*. Prentice Hall of India: New Delhi. (Chapter 3)

Ramesh, M.S. 1985, *Principles and Practice of Business Organisation, Administration Management*, Kalyani Publishers: New Delhi. (Volume 1, Chapters 4 to 7)

Singh, B.P., and T.N. Chhabra, 1988, *Business Organisation & Management*, Kitab M Allahabad, (Part One, Chapters 4 & 5)

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## 2.10 ANSWERS TO CHECK YOUR PROGRESS

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- A) 1 (i) unlimited (ii) proprietor/owner (iii) small (iv) one (v) proprietor/owner  
2 (i) False (ii) True (iii) False (iv) True (v) False
- B) 1 (i) ten (ii) unlimited (iii) sleeping (iv) two (v) partnership deed (vi) partner by estopped (vii) limited partner  
2 (i) False (ii) False (iii) True (iv) False (v) True (vi) False (vii) False (viii) True
- C) 1 (i) False (ii) True (iii) False (iv) True (v) False (vi) False (vii) True (viii) False

D) 1 (i) False (ii) False (iii) False (iv) True (v) False

2 (i) limited (ii) ten (iii) unlimited (iv) self-help and mutual help (v) 9%

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## 2.11 QUESTIONS FOR PRACTICE

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- 1) What do you understand by sole trader organisation? State merits and limitations of sole trader organisation?
- 2) Partnership organisations emerged essentially because of the limitations and failures of the sole proprietorships. Discuss.
- 3) What is partnership? How does it differ from a joint stock company?
- 4) What is a joint stock company? Explain how it overcomes the limitations of non--corporate form of organisation.
- 5) Discuss the special features of a cooperative form of organisation. How it is different from a company?
- 6) What is the main objective of a cooperative form of organisation? Explain its merits and limitations.

**Note:** These questions will help you to understand the unit better. Try to write answer for them. But do not send your answers to the University. These are for your practice only.