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Types of Business

Business

A business is an organization that uses economic resources or inputs to provide goods or services to customers in exchange for money or other goods and services.
Business organizations come in different types and forms.

3 types of business

There are three major types of businesses:

1. **Service Business**
   A service type of business provides intangible products (products with no physical form). Service type firms offer professional skills, expertise, advice, and other similar products.
   Examples of service businesses are: schools, repair shops, hair salons, banks, accounting firms, and law firms.
2. **Merchandising Business**
   This type of business buys products at wholesale price and sells the same at retail price. They are known as "buy and sell" businesses. They make profit by selling the products at prices higher than their purchase costs. A merchandising business sells a product without changing its form.
   Examples are: grocery stores, convenience stores, distributors, and other resellers.
3. **Manufacturing Business**
   Unlike a merchandising business, a manufacturing business buys products with the intention of using them as materials in making a new product. Thus, there is a transformation of the products purchased.
   A manufacturing business combines raw materials, labor, and factory overhead in its production process. The manufactured goods will then be sold to customers.
   Hybrid Business
   Hybrid businesses are entities that may be classified in more than one type of business. A restaurant, for example, combines ingredients in making a fine meal (manufacturing), sells a bottle of cold drink (merchandising), and caters to customer's orders (service).
   Nonetheless, these entities may be classified according to their major business interest. In that case, restaurants are more of the service type – they provide dining services.

Forms of Business Organization

The following are the basic forms of business ownership:

I. **Sole Proprietorship**
   A sole proprietorship is a business owned by only one person. It is easy to set-up and is the least costly among all forms of ownership.
   The sole proprietorship form is usually adopted by small business entities because they are relatively easy to start up. Also, the owner is entitled to all the profit that the sole proprietorship collects. On the other hand, sole proprietorships can be risky because there is no separation between the owner and the business. The owner faces unlimited liability. In other words, the owner remains personally liable for any losses or debts that the sole proprietorship incurs. They can also be held legally responsible for violations committed by the business or its employees.
   A sole proprietorship does not involve many of the complex filing requirements associated with other types of business structures such as corporations. Sole proprietorships allow persons to report business income and expenses on their individual tax returns.

Advantages of a Sole Proprietorship

There are many reasons why a person would choose to start their business up using a sole proprietorship structure. Some of the main advantages of sole proprietorships include:

1. **Ease of formation:**
   Starting a sole proprietorship is much less complicated than starting a formal corporation, and also much cheaper. The proprietorship can be named after the owner, or a fictitious name can be used to enhance the business' marketing.

2. **Decision making:**

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Control over all business decisions remains in the hands of the owner. The owner can also fully transfer the sole proprietorship at any time as they deem necessary.

3. **Tax benefits:**
   The owner of a sole proprietorship is not required to file a separate business tax return. Instead, they will list business information and figures within their individual tax return. This can save additional costs on accounting and tax filing. The business will be taxed at the rates applied to personal income, not corporate tax rates.

4. **Employment:**
   Sole proprietorships can hire employees. This leads to job creation which is greatly encouraged specially in developing countries.

Disadvantages of Sole Proprietorships
Forming a sole proprietorship does involve some risks, mainly to the owner of the business, as legally speaking they are not treated separately from the business. Some disadvantages of sole proprietorships are:

1. **Liability:**
   The business owner will be held directly responsible for any losses, debts, or violations coming from the business. For example if the business must pay any debts, these will be satisfied from the owner's own personal funds. The owner could be sued for any unlawful acts committed by the employees.

2. **Lack of "continuity":**
   The business does not continue if the owner becomes deceased or incapacitated, since they are treated as one and the same.

3. **Difficulty in raising capital:**
   Since the initial funds are usually provided by the owner, it can be difficult to generate capital. Sole proprietorships do not issue stocks or other money-generating investments like corporations do

So, while sole proprietorships do not necessarily create more liabilities, they do expose the business owner to a risk of being sued. Lawsuits can be filed against the business owner for legal violations, as well as to collect any outstanding debts.

II. Partnership
A partnership is a business owned by two or more persons who contribute resources into the entity. The partners divide the profits of the business among themselves. In general partnerships, all partners have unlimited liability.
Definition of Partnership as per Indian Partnership Act, 1932:
"Partnership is the relation between persons who have agreed to share profits of a business carried on by all or any one of them acting for all."
Persons who have agreed to enter into partnership with one another are called individually called "partners" and collectively a "firm", and the name under which their business is carried on is called the "firm name."

Essential elements of Partnership:
From the statutory definition of partnership, the essential elements of partnership can be understood as:

1. Persons: There should be at least two persons to form a partnership or partnership firm.
2. Agreement: There should be an agreement between those persons who are forming a partnership. The agreement is the foundation of partnership. Partnerships can only arise out of contract and not from status
3. Profits of a business: There should be a business carried on by the partnership and that too with an intention to make and share profits of that business. Therefore it follows that - no business no partnership, and no intention to share profit, no partnership. Though no specific mention of loss is made, it is assumed that sharing profits implies sharing losses also

4. Carried on by all or any one of them acting for all: The business may be carried on by any one or more than one of the partners. “Acting for all” implies that a partner conducting the business on should be understood as conducting business on behalf of all the partners. Each partner would be responsible for the acts of every other partner in relation to the firm. As far as outsiders are concerned, the partners and the firm are one and the same.
5. Mutual agency: A partner is an agent of the firm for the acts that he does on behalf of the firm, whereby he can bind the other partners for such acts. The other partners would be in the position of a principal for such acts. With regards too other partners’ acts, he will be in a position of a principal.

Advantages of Partnership

1. Easy to set up
2. More capital can be brought into the business.
3. Partners bring new skills and ideas to a business
4. Decision making can be much easier with more brains to think about a problem.
5. Partners share responsibilities and duties of the business.
6. Division of labour is possible as partners may have different skills.

Disadvantages of Partnership

1. There is unlimited liability: All the partners are responsible for the debts of the firm and if the business goes bankrupt, all the partners will have to clear the debts even if they have to sell of their personal belongings.
2. Disagreement among the partners can lead to problems for the business.
3. There is a limit to the capital invested. Because of the fact that maximum 100 members are allowed, the business may find it difficult to expand after a certain limit.
4. There is no continuity of existence. Partnership is dissolved if one of the partners die or resigns or becomes bankrupt.

** Earlier the maximum limit of partners was:- In case of banking business – 10. In case of any other business – 20. As per the new Companies Act, 2013, the same has been simplified and the limit has been raised to 100 partners for any business.*

Partnership Deed

Before starting a partnership business, all the partners have to draw up a legal document called a Partnership Deed of Agreement. It usually contains the following information:

1. Names of included parties - includes all names of people participating in this contract
2. Commencement of partnership- includes when the partnership should begin. The date of the contract is assumed as this date, if none is given.
3. Duration of partnership - includes how long the partnership should last. It is automatically assumed that the death of one of the contracting parties breaks the contract, unless otherwise stated.
4. Business to be done - includes exactly what will be done in this partnership. This section should be very particular to avoid confusion and loopholes.
5. Name of firm - includes the name of the business entity.
6. Initial investments - includes how much each partner will invest immediately or by installments.
7. Division of profits and losses - includes what percentages of profits and losses each partner will receive. If it is not a limited partnership, then there is unlimited liability (each partner is responsible for all partners' debts, including their own).
8. Ending of the business - includes what happens when the business winds down. Usually this includes three parts: 1) All assets are turned into cash and divided among the members in a certain proportion; 2) one partner may purchase the others' shares at their value; 3) all property is divided among the members in their proper proportions.
9. Date of writing - includes simply the date that the contract was written.

There is another form of partnership which combines the ease of formation with limited liability as in the case of companies. It is known as Limited Liability Partnership (LLP). Minimum number of members is 2 but there is no no limit on maximum number. In India LLPs are governed by the Limited Liability Partnership Act, 2008

III. Company

A company can be defined as “An artificial person created by law, having a separate legal entity, with a perpetual succession.”

A joint stock company (or simply company) is a voluntary association of persons generally formed for undertaking some business activity for which the members contribute money. The money so contributed

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constitutes the capital of the company. The capital of the company is divided into small units called shares. Since members invest their money by purchasing the shares of the company they are known as shareholders and the capital of the company is called share capital.

In India, the joint stock companies are governed by the Companies Act, 2013 (previously the Companies Act, 1956).

Characteristics of Company:

1. **Artificial person:** It is created by law and does not have any physical attributes of a natural person. But it has got a legal status as a natural person.
2. Formation: the process of formation of company is time consuming and complex compared to proprietorship and partnership. A company comes into existence only when it is registered under the Companies Act, which requires preparation of several documents and compliance with several legal requirements.
3. **Separate legal entity:** Being an artificial person, a company exists independent of its members. It can enter into contracts, buy and sell goods and services, employ people, conduct any lawful business, sue and be sued in the court of law. A shareholder cannot be held responsible for the acts of the company.
4. **Common seal:** Common seal is the official signature of the company. Since the company has no physical existence, it acts through its Board of Directors. Any document with the common seal duly signed by authorized signatory is binding on the company.
5. **Perpetual existence:** The company enjoy continuous existence. Even if the shareholders cease to be so due to death, lunacy, insolvency or any other incapacitation the company continues to exist. It is a creation of law and can only be dissolved by law.
6. **Membership:** A minimum of 2 persons are required to form a private limited company and the maximum number is 200 (as per Companies Act, 2013). A minimum of 7 persons can form a public limited company but there is no limit on the maximum number.
7. **Limited liability of members:** The liability of the shareholders is limited to the extent of the amount of shares he holds. In other words, a shareholder can only be held liable to the extent of face value of shares he holds and if he has already paid it, which is usually the case, he cannot be asked to pay any further amount. Face value is the value of the share which is mentioned in the share certificate as distinguished from the market value which is the value at which it is bought and sold.
8. **Transferability of shares:** The shareholders of a public company are free to transfer their shares as and when they wish without any need for consent from other shareholders.
9. **Separation of ownership and management:** Shareholders across the globe may invest in the company. It is neither possible nor practicable that they participate in its day to day management. The day to day affairs are managed by their elected representatives called directors. These directors act as an agent as well as trustee for the shareholders. The shareholders participate in deciding the general policies through annual general meetings.

Types of Companies

The broad classification of companies is done on the limit on membership namely:

1. Private company: a company whose shares may not be offered to the public for sale and which operates under legal requirements less strict than those for a public company.
2. Public company: a company whose shares are traded freely on a stock exchange.

Difference between Private company and Public company

No.	Basis	Private company	Public company
1.	Number of members	Minimum 2 members; maximum 200.	Minimum 7 members; maximum – no limit
2.	Nature of ownership	Usually family owned companies where members more or less are known to each other	Owned by public at large which may be across a nation or the globe

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3.	Minimum paid up capital	Rs. 1 lakh	Rs. 5 lakh
4.	Name	Must suffix "Private Limited" to its name	Must suffix the word "Limited" to its name
5.	Public subscription	Cannot raise capital by offering shares to the public	Can invite the public to purchase its securities through issue of debentures
6.	Commencement of business	Can commence business immediately after incorporation	Can start business only after obtaining certificate of commencement of business
7.	Transfer of shares	Transfer of shares restricted	Shareholders can freely transfer shares

Other classifications:

a. **Government company:** where the Government owns not less than 51% of the share capital. E.g. Bharat Sanchar Nigam Ltd. (BSNL), Coal India Ltd., Indian Oil Corporation
b. **Statutory company:** A company created by special Act of the Parliament. E.g. Life Insurance Corporation of India, Securities Exchange Board of India
c. **Foreign company:** A company which is registered in a country outside India having its business in India. E.g. Citi Bank, Honda Motors
d. **Indian / Domestic company:** A company registered in India under the Companies Act. E.g. Tata Iron & Steel Company, Reliance Industries Ltd.
e. **Multinational company:** A company which is registered in one country but carries on business in number of other countries. E.g. Nestle, Coca Cola, Microsoft

IV. Cooperative Society

A cooperative is a business organization owned by a group of individuals and is operated for their mutual benefit. The persons making up the group are called members. Cooperatives may be incorporated or unincorporated. Some examples of cooperatives are: water and electricity (utility) cooperatives, cooperative banking, credit unions, and housing cooperatives.

Difference between Partnership and Company form of organization

The most common forms of business in India are Proprietorship, Partnership and Company. Proprietorship form of business is used when there is a single owner of the business. When the number of owners are more than one, partnership or company form of organization are resorted to. The differences between Partnership and Company form of organization can be summarized as below:

1. Number of members: The minimum number of members in case of partnership as well as private company is 2 whereas the minimum number of members in case of public company is 7. The Companies Act, 2013, has prescribed the maximum number of members in case of a partnership

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firm should not be more than 100. *(As per the previous Companies Act, 1956, the maximum limit in case of partnerships was 10 and 20 for banking and other business respectively.)*
In case of private companies, the maximum limit has been increased by the new Companies Act, 2013, from 50 to 200. There is however no maximum limit on the number of members in a public company.

2. Separate legal entity: A Partnership firm has no separate legal entity distinct from its partners. A Company on the other hand, is a separate legal entity distinct from its members.

3. Liability: In partnership, each partner has unlimited liability and is personally liable for the debts of the firm. In a company, on the other hand, a shareholder has limited liability – limited to the extent of share capital subscribed by him.
   In order to facilitate the concept of limited liability in partnerships as well, a new form of partnership entity has been introduced under which the liability of the partners in a partnership firm is also limited and such form of organization is called Limited Liability Partnership.

4. Management: All the partners in a partnership firm are entitled to take part in the management of the business unless stated otherwise but in the case of company the right to control and manage the business is vested in the Board of Directors elected by the shareholders.

5. Transfer of interest: A partner cannot transfer his interest in the partnership firm without the consent of all the partners. He may however assign his share in the partnership but the assignee merely becomes entitled to the financial benefits in respect of the share and does not become a partner unless the other partners agree. In case of private companies, transfer of share requires the permission of the Board of Directors. But in case of a public company a shareholder can transfer his shares freely without restriction and the transferee succeeds to all rights of membership.

6. Audit of accounts: In case of companies, annual audit of accounts are mandatory. However in case of partnership firms, audit is necessary only if the annual turnover of sales exceed certain specified limits.

7. Registration: A partnership firm may or may not be registered. However in case of a company, registration is essential.

8. Minimum paid-up capital: In case of partnership there is no minimum prescribed capital. In case of private company the minimum paid-up capital is Rs. 1 Lakh and in case of public companies the minimum paid-up capital is Rs. 5 Lakhs.

9. Distribution of profits: In a partnership firm, the profits are shared among the partners as per the partnership deed. In case of a company, the members get a share in profits only when dividend is declared by the Board of Directors and approved by the members.

10. Winding up: A partnership can be wound up any time by any partner if it is ‘at will’ without any legal formalities. In case of company, no one member can require it to be wound up at will and winding up involves legal formalities.

Company or Partnership – which form is advisable

A company form of organization is preferred where the business is of potentially large size involving high amount of capital investment. Also since a partnership cannot raise money from the public it must convert itself into a company if it needs large amount of capital. It should however that formation formalities, compliance requirement and cost of running a company is fairly high compared to a partnership firm.

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On the other hand setting up a partnership is an easy process and there are not many compliance requirements as well. Thus for a small business it is advisable to opt for a partnership firm of business structure as not only the cost of setting up is less but there are hardly any statutory regulations that needs to be complied with. It is pertinent to note that if a partnership has grown in size it can always be converted into a company any time.