

Industrial Ownership

Learning Objectives

After studying this chapter, you should be able to :

- Explain the concepts of private sector and public sector
- Enumerate the different forms of industrial organisation
- Explain the features, merits and limitations of Sole Proprietorship, Partnership, Cooperative Society and Company
- Distinguish between various types of organisation
- Make a choice of form of business organisation
- State the basic factors to be considered while starting a business

An industrial undertaking may be defined as an organisation engaged in industrial activities. This term is used interchangeably with industrial enterprise, business firm, business concern, etc.

India is a mixed economy where both public and private sectors coexist. Thus, industrial undertakings may be classified sector-wise as follows:

- (i) Private sector enterprises which are owned and controlled by private entrepreneurs.

- (ii) Public sector enterprises which are owned and controlled by the Government.
- (iii) Joint sector enterprises whose capital is held jointly by the Government, private entrepreneurs, and the public.

5.1 PRIVATE AND PUBLIC OWNERSHIP

Private Enterprise

A private sector enterprise is owned, controlled and managed by individuals or groups of individuals known as entrepreneurs. The examples of private enterprises include ESCORTS, Reliance Industries, Bombay Dyeing, Tata Motors, Ranbaxy, etc.

The basic characteristics of a private enterprise are as follows :

- (i) It is owned by private individuals or groups of individuals who provide capital to the business firm.
- (ii) It is managed by the owners or professional managers appointed by the owners.
- (iii) Its main objective is to earn profit and generate wealth for the owners.
- (iv) It is accountable for results to the owners.
- (v) Its financial management is in the hands of its owners.
- (vi) Day-to-day administration is in the hands of owners or professional managers.

Public Enterprise

According to A.H. Hansen, "A public enterprise means government ownership of a business undertaking". In other words, a public enterprise is owned, controlled and managed by the government. The Central, the State or the local government may singly or jointly contribute capital for the public enterprise. Some of the very popular public enterprises include Life Insurance Corporation of India (LIC), Hindustan Machine Tools Ltd. (HMT), Food Corporation of India (FCI), State Trading Corporation of India (STC), etc.

The salient features of a public enterprise are as follows:

- (i) The capital of such an enterprise is contributed by the Government—the Central Government or the State Government or the Local Government, either singly or jointly.
- (ii) The management and control of such enterprises exclusively rest in the Government.
- (iii) Public welfare or service is the main objective of the public enterprises. The profit motive is secondary.
- (iv) Public enterprises are accountable to the general public.
- (v) The financial management of a public enterprise is under the control of the government.
- (vi) It is managed by officials who are the employees of the government.

Joint Enterprise

Joint sector enterprises are those wherein the ownership, management and control are jointly shared by the Government, private entrepreneurs and the public. The capital of a joint sector undertaking may be shared as follows : the Government 49 per cent, private businessman 25 per cent and the general public 49 per cent. In any case, majority shareholdings would be with the private sector in a joint sector enterprise.

The responsibility of management of a joint sector enterprise lies with the private entrepreneurs. Joint sector is an attempt by the Government to encourage private entrepreneurs to undertake big industrial ventures. Joint sector enterprises include the Gujarat State Fertilizer Co., Indian Rare Earths Ltd., Cochin Refineries,

The main characteristics of a joint sector or mixed enterprise are as under :

- (i) Its capital is provided by the Government and private sector entrepreneurs and the investing public.
- (ii) Its management may be entrusted to the private entrepreneurs.
- (iii) It combines both social and profit objectives.
- (iv) It is responsible to both the government and the private entrepreneurs.

Forms of Private Sector Enterprises

Private sector organisations are owned by the businessmen or entrepreneurs. Businessmen may organise business units in the following forms :

1. Sole Trader. He is a person who carries on business exclusively by and for himself. He provides capital and management to the business. There is no difference between the sole trader and his business. He does not share the business profits with anybody.
2. Joint Hindu Family. The business of a Hindu is inherited by his heirs under the Hindu Law. Such a business is known as Joint Hindu Family Business. The head of the family known as Karta, who manages the affairs of the business. The other male members of the Hindu family are known as coparceners.
3. Partnership. It is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all. A partnership firm comes into existence when two or more persons enter into agreement to run a business and share its profits. The maximum number of members of a partnership could be twenty.
4. Joint Stock Company. It is an artificial person created by law (Companies Act). It is an invisible and intangible person and exists only in the eyes of law. Being a mere creature of law, it possesses only those characteristics which the charter of its creation known as Memorandum of Association confers upon it.

5. Cooperative Society. It is also a body corporate. It is formed and registered under the Cooperative Societies Act. It is a voluntary organisation of its members. Its success depends upon the cooperation among its members.

Sole tradership, Joint Hindu Family and Partnership firms can't do the banking business.

Forms of Public Enterprises

Public sector enterprises are owned by the Government. They are generally organised on the following patterns :

1. *Departmental Undertaking*. It is the oldest method of organising state enterprises. It is financed and controlled by a department of the Government. Railways, posts, broadcasting and defence undertakings are a few examples of departmental enterprises.
2. *Government Company*. It is a company in which not less than 51% of the paid up share capital is held by the Government. It is formed and registered under the Companies Act, 1956 which contains special provisions relating to government companies.
3. *Public Corporation*. It is an autonomous business undertaking created by law to conduct the activities entrusted to it. It is a body corporate which is set up under a special Act passed by the Central or State legislature. Since it is created by a statute, it is also known as statutory corporation.

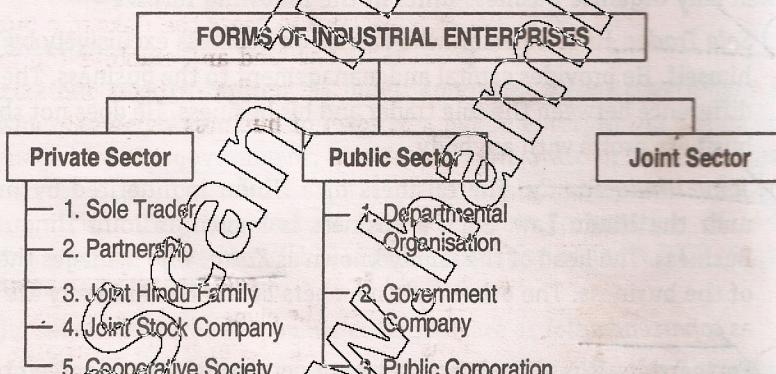


Fig. 5.1. Forms of Industrial Enterprises

5.2 SOLE PROPRIETORSHIP

Definition of Sole Proprietorship

According to Haney, "The sole proprietorship is the form of business organisation at the head of which stands an individual who is responsible, who directs its operations and who alone runs the risk of failure," C.S. Gerstenberg defines sole trading as "that form of business organisation which is started and run by one person who bears profits and losses of it."

A sole proprietor is a person who carries on business exclusively by and for himself. It is very easy to start a small business on sole tradership basis because of very few legal formalities. According to Kimball and Kimball, "The individual proprietor is the supreme judge of all matters pertaining to his business subject only to general laws of the land to such special legislation as may affect his particular business."

Definitions of Sole Proprietorship

A sole proprietor is a person who carries on business exclusively by and for himself. He is not only the owner of the capital of the undertaking, but is usually the organiser and manager and takes all the profits or responsibility for losses.

—James Stephenson

Sole trader business is 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 business.

—J.L. Hansen

The sole proprietorship is the form of business organisation at the head of which stands an individual as one who is responsible, who directs its operations and who alone runs the risk of failure.

—L.H. Haney

A sole trader is an individual who directs and bears the risks of a business in which he owns or borrows the capital, rents the land and employs the necessary labour. He manages the business and takes the profits or bears the losses. Sole tradership is the oldest and the simplest form of business ownership and is very suitable for carrying small business operations.

Features of Sole Proprietorship

This form has the following characteristics :

- 1. Common Identity or No Separate Entity.** A sole tradership concern has no separate legal entity independent of the owner. The owner and the business concern are one and the same. The owner owns everything the business owns and he owes everything the business owes.
- 2. Capital.** In sole tradership, the capital is employed by the owner himself from his personal resources.
- 3. Unlimited Liability.** The liability of the proprietor for the debts of the business is unlimited. The creditors have the right to recover their dues even from the personal property of the proprietor in case the business assets are not sufficient to cover their debts.
- 4. Easy Formation.** It is very easy to form proprietorship. In most of the cases even licence is not required. Peddlers, hawkers, small vendors and shopkeepers can start business at their own will, provided it is not illegal, and against the public interest.

5. One Man Control. Sole tradership is a one man show. The sole trader provides management to the business. He takes all the decisions, procures material resources, employs personnel and directs and controls the affairs of the enterprise.

6. Profits and Losses. The surplus arising in the business of the sole trader entirely belongs to him and similarly all the business losses and risks are to be borne by him alone.

Merits of Sole Proprietorship

A sole tradership firm enjoys the following benefits :

- (i) **Easy Formation.** The formation of a sole tradership concern is easier as compared to other forms of organisation. A person with small amount of capital can start the business without undergoing much legal formalities.
- (ii) **Quick Decision-making.** Sole tradership facilitates quick decision making and prompt action as the sole trader has exclusive control over his business.
- (iii) **Secrecy.** It is easy to preserve secrecy in business in case of sole proprietorship. The important clues of business can be kept as closely guarded secrets by the proprietor.
- (iv) **Flexibility.** The sole trader is free to carry out any business as the situation demands. The flexibility is available because the sole trader is the sole owner and he has invested a small amount of capital.
- (v) **Personal Touch.** A sole trader can maintain intimate personal contacts with his customers. Close personal touch with the customers enhances the reputation of the firm.
- (vi) **Direct Incentive.** In this form of business organisation, the proprietor takes all the profits and bears all the risks and losses. Thus, there is a direct relationship between effort and reward. This will motivate the owner of the business to work hard to achieve maximum efficiency for the business.
- (vii) **Independent Way of Life.** Sole proprietorship offers an independent way of life for people who have necessary skills but do not wish to serve others. This provides an excellent opportunity for self-employment of persons of small means with professional skills.
- (viii) **Low Overheads.** The overhead costs of management are less as compared to other forms of business enterprises.
- (ix) **Few Government Regulations.** The sole tradership concern is subject to the minimum of government regulations.

Limitations of Sole Proprietorship

Sole tradership suffers from the following drawbacks :

- (i) **Limited Capital.** The capital which a sole trader can raise are limited. He can either depend on his personal resources or on his borrowing capacity. The limitation of financial resources may put hurdles in the expansion of the business.
- (ii) **Lack of Managerial Skills.** All the managerial functions, which are essential for the successful operation of a business are performed by the sole trader himself. Thus, benefits of specialisation are not available.

- (iii) **Unlimited Liability.** The liability of the sole trader is unlimited. The business creditors can even recover their debts from the personal assets of the proprietor. The proprietor may be completely ruined in case of failure of his business. This factor puts a ceiling on the growth and expansion of his business.
- (iv) **Uncertain Life of Business.** There is a doubt about the continuity of the business because of sole trader operates on a small scale and his activities are less diversified. The owner may be compelled to close his business if he is not successful. Moreover, death and insanity of the proprietor also lead to closure of business.

From the above account of the merits and limitations it becomes clear that it is only personal services like repair work, tailoring etc. small factories, retail shops and professional activities which can be set up as sole proprietary organisations. In India, this form of organisation is quite popular and accounts for the largest number of business units because of its advantages.

5.2.1 Joint Hindu Family

Meaning of Joint Hindu Family

The Joint Hindu Family firm comes into existence by operation of law. It is governed by the Hindu law and Hindu customs. *If the business set up by a person is carried on by male members of his family after his death, it is called Joint Hindu Family business.*

A Joint Hindu Family has an entity of its own and its members are merely co-owners. It enjoys a continuous existence as long as partition is not affected. The business of the family is run by the head of the family known as 'Karta'. The liability of Karta is unlimited. The other members of the family business are known as coparceners. The coparceners cannot question the judgment of the 'Karta' in managing the business of the firm. They cannot ask for accounts of profit or loss of the business. Karta has the right to control the affairs of the business and he manages the income and expenditure of the business.

Under Hindu law there are two systems of inheritance. These are :

1. **Dayabhaga Law.** This system prevails only in West Bengal. Under this system the male as well as female members of Joint Hindu Family can become copartners as well as co-parceners.
2. **Mitakashara Law.** This system prevails all over India except West Bengal. Under this system only male members can become coparceners in the Joint Hindu Family business.

Features of Joint Hindu Family

The salient features of Joint Hindu Family business are outlined below :

1. **Male Members.** The membership of a Joint Hindu family business consists of only the male members. The membership is not created by an agreement but is determined by birth. The membership is restricted to three successive generations.

- 2. Membership by Birth.** A person automatically becomes a member in Joint Hindu Family by taking birth in that family. There is no need for any agreement.
- 3. Management.** The management of such a business vests in the eldest members of the family, called *Karta*. The *Karta*, however, may associate other members to assist him in the management of business.
- 4. Liability.** The liability of the *Karta* is unlimited i.e., even his personal assets can be used for the payment of business dues. The liability of other members is limited to the extent of their share in the property of the family business.
- 5. Registration.** It is not compulsory for Joint Hindu Family Business to get registration certificate as it is governed by the Hindu Law Act.
- 6. Dissolution of Business.** The Joint Hindu Family business comes to an end when all the members notify that they are not members of the Joint Hindu Family.
- 7. Minor Members.** In Joint Hindu Family Business a child becomes a member by birth only, so there is no restriction for a minor to become a member of the business.
- 8. Rights.** All the members of Joint Hindu Family Business have the rights to inspect the accounts. The members can also claim their share in the family property at the time of partition of the family.
- 9. Governed by Hindu Law.** The control and management of the Joint Hindu Family firm is done according to the Hindu Law. The Hindu Law consists of two schools Mitakshara and Dayabhaga. The rights and duties of its members are also governed by the Hindu Law.
- 10. Continuity.** Its continuity is not affected by the death of a family member. Next generation controls the business after the first generation and thus, business goes forever.

5.3 PARTNERSHIP

Meaning of Partnership

Partnership is an association of persons who agree to combine their financial resources and managerial abilities to run a business and share profits in an agreed ratio. According to Lewis H. Haney, "Partnership may be defined as the relation existing between persons who agree to carry on a business in common with a view to private gain".

The Indian Partnership Act defines partnership as follows : "Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all." The persons who have agreed to join in partnership are individually called 'partners' and collectively a 'firm'. A partnership firm can be formed with a minimum of two partners and it can have a maximum of twenty partners.

Definitions of Partnership

"Two or more individuals may form a partnership by making a written or oral agreement that they will jointly assume full responsibility for the conduct of the business."

—J.A. Shubin

Partnership is the relation between two or more persons who have agreed to share the profits of the business carried on by all or any of them acting for all.

—The Indian Partnership Act, 1932

Partnership may be defined as the relation between the persons who agree to carry on a business in common with a view to private gain.

—L.H. Haney

Features of Partnership

The features of partnership firm are explained below :

1. **Number of Members.** At least two persons are required to form a partnership. In any partnership where the number of partners is less than two, the partnership is dissolved. The maximum permissible number of partners is 20 in case of ordinary business and 10 in banking business. If the number of partners exceeds this, it becomes an illegal partnership.
2. **Agreement.** There must be an agreement between the partners to form a partnership. This agreement can be oral or written. The document containing the agreement of partners is known as *Partnership Deed*.
3. **Lawful Business.** A partnership may undertake any lawful business activity. The partnership can be formed only for the purpose of carrying on business, which is legal. Joint theft or smuggling carried by two or more persons cannot be considered as partnership.
4. **Sharing of Profits.** There must be an agreement between the partners to share the profits (and losses) of the business.
5. **Agency Relationship.** Every partner is the proprietor as well as the agent of the firm. The business of the firm may be carried on by all or any of them acting for all. Each partner is entitled to take part in management of the business of the firm and to represent other partners in dealings with third parties.
6. **Unlimited Liability.** As a result of contractual relation between the partners of a firm, all the partners are liable jointly and severally for the debts and obligations of the firm to an unlimited extent. It means that if the assets of the firm are not sufficient to meet the obligations of creditors of the firm, the private assets of the partners can be attached to satisfy their claims.

Merits of Partnership

The advantages of a partnership firm include the following :

- (i) **Ease of Formation.** A partnership firm can be formed easily by an agreement between the prospective partners to carry out the business of the firm and share risks. There is no compulsion with respect to registration of the firm.
- (ii) **More Funds or Capital.** In a partnership, the capital is contributed by a number of partners. This makes it possible to raise larger amount of funds as compared to a sole proprietor and undertake additional operations when desired.
- (iii) **Sharing of Risks.** The risks involved in running a partnership firm are shared by all the partners. This reduces the anxiety, burden and stress on individual partners.
- (iv) **Balanced Decision-making.** The partners can oversee different functions according to their areas of expertise. Because an individual is not forced to handle different activities, this not only reduces the burden of work but also leads to fewer errors in judgements. As a consequence, decisions are likely to be more balanced.
- (v) **Pooling of Skills.** The partners can provide knowledge and skills in different areas of business for its better working.
- (vi) **Secrecy.** A partnership firm is not legally required to publish its accounts and submit its reports. Hence it is able to maintain confidentiality of information relating to its operations.
- (vii) **Flexibility in Operations.** Partnership firms can make changes in their size, capital etc. without prior permission of government. The partners can take decisions in the firm according to changes taking place in the external environment whenever it is necessary.
- (viii) **Scope for Expansion.** Compared to sole proprietorship there is more scope for the expansion and growth in a partnership. The partners can arrange larger funds from their own wealth as well as from their borrowings.

Limitations of Partnership

A partnership form of organisation suffers from the following major limitations :

- (i) **Uncertainty of Existence.** The existence of a partnership firm is very uncertain. The retirement, death, bankruptcy or lunacy of any partner can put an end to the partnership.
- (ii) **Unlimited Liability.** The liability of all the partners is unlimited. In case of losses the partners will not only lose their business property but creditors can claim over their personal property also to get their accounts settled.
- (iii) **Limited Funds.** Capital contribution by partners from own sources or borrowings may not be enough to finance large-scale business operations.
- (iv) **Conflicting Interests.** Differences between partners may affect the firm's business. If such differences are not quickly resolved, continuance of partnership itself may be threatened.
- (v) **Non-transferability of Interest.** A partner cannot transfer his interest in the firm to outsiders without the unanimous consent of all other partners. This discourages the people from investing in partnership firms.

(vi) **Less Public Confidence.** The public has less trust and faith in partnership firm because the accounts and annual reports of partnership firm are not published. So people do not have trust in their dealings. *QmP*

Despite its various disadvantages or limitations, partnership firm has not lost popularity because it is a simple and convenient form of proprietorship. This form of organisation is suitable where the size of the business is relatively small and the capital requirements are low. It is also suitable where the partners do not trade but use their professional skills. That is why, this form of organisation is the most popular among chartered accountants, lawyers, stock brokers, estate agents, solicitors and doctors.

Types of Partnership (Based on Duration): According to duration, there can be three types of partnership as follows :

- Partnership at Will.** Such a partnership exists at the Will of the partners. That is, it can be brought to an end wherever any partner gives notice of her/his intention to do so.
- Particular Partnership.** A particular partnership is formed for undertaking a particular venture. It comes to an end automatically with the completion of the venture.
- Partnership for a Fixed Duration.** Such a partnership is for a fixed period of time say for a period of 3 years, 5 years or any other duration.

Types of Partnership (Based on Liability): According to liability there can be two types of partnership as follows :

- General Partnership.** In general partnership, the liability of partners is unlimited and joint. The partners enjoy the right to participate in the management of the firm and their acts are binding on each other as well as on the firm. Registration of the firm is optional. The existence of the firm is affected by the death, lunacy, insolvency or retirement of the partners. *QmP*
- Limited Partnership.** In limited partnership, the liability of at least one partner is unlimited whereas the rest may have limited liability. Such a partnership does not get terminated with the death, lunacy or insolvency of the limited partners. The limited partners do not enjoy the right of management and their acts do not bind the firm or the other partners. The position of a limited partner is similar to that of a shareholder of a joint stock company in respect of his liability.

The following are the important features of limited partnership :

1. Limited partnership must be registered with the Registrar of Joint Stock Companies failing which it will be regarded as an ordinary partnership.
2. There must be at least one general partner whose liability is unlimited besides the limited partners.
3. A limited partner contributes capital which he is not allowed to withdraw during his term of limited partnership.
4. A limited partner may assign his interest to another person with the consent of the general partners.

5. A limited partner is not entitled to take part in the management of the business. He cannot act as the agent of the firm or of the other partners. He may, however, inspect the books of the firm and give advice to the general partners who actually manage the business.

TABLE 5.1: Types of Partners

| Type | Capital Contribution | Management | Share in Profits/Losses | Liability |
|--------------------------------|-----------------------------|---|---|-----------|
| 1. Active Partner | Contributes capital | Participates in management | Shares profits/losses | Unlimited |
| 2. Sleeping or Dormant Partner | Contributes capital | Does not participate in management | Shares profits/losses | Unlimited |
| 3. Secret Partner | Contributes capital | Participates in management, by secretly | Shares profits/losses | Unlimited |
| 4. Nominal Partner | Does not contribute capital | Does not participate in management | Generally does not share profits/losses | Unlimited |
| 5. Partner by Estoppel | Does not contribute capital | Does not participate in management | Does not share profits/losses | Unlimited |
| 6. Partner by Holding Out | Does not contribute capital | Does not participate in management | Does not share profits/losses | Unlimited |

TABLE 5.2 : Partnership vs. Sole Tradership

| Basis | Partnership | Sole Trade |
|----------------------|---|--|
| 1. Number of Members | The maximum number of members is two and maximum twenty in ordinary business and ten in case of banking business. | A sole trading concern is owned by one person. |
| 2. Agreement | A partnership arises only as a result of agreement between the partners. | There is no question of agreement. |
| 3. Capital | It is economically more strong as partners can raise more capital. | It is economically weak. The ability of the sole trader to provide capital is limited. |
| 4. Secrecy | In partnership, business secrets are open to every partner. | In sole trading concern, the business secrets are not open. |
| 5. Survival | The partnership firm may be continued even after the death of a partner. | It comes to an end with the death of the sole trader. |
| 6. Decision making | Decision-making may be delayed as all the partners must agree to important decisions. | Decision-making is very quick as the individual is not required to consult anybody. |

5.4 COOPERATIVE SOCIETY

Meaning of Co-operative Society

~~A co-operative society is a voluntary association of persons of moderate means, unite together to protect and promote their common economic and social interests.~~ It is based on the principles of collective effort, mutual self-help, equality, democracy, distributive justice and freedom. It represents an attempt by poor and persons to protect themselves against the exploitation and oppression of the economically strong.

Definitions of Cooperative Society

"Co-operative organisation is a society which has its objectives for the promotion of economic interest of its members in accordance with cooperative principles."

—The Indian Cooperative Societies Act, 1912

"Cooperative is a form of organisation wherein persons voluntarily associate together as human beings on the basis of equality for the promotion of the economic interest of themselves."

E.H. Calvert

Features of Cooperative Society

The essential characteristics of a co-operative society are as follows :

- 1. Voluntary Association.** Co-operative organisation is basically a voluntary association of individuals seeking to improve their economic status through joint efforts. No one is forced to become a member or to continue as a member.
- 2. Legal Status.** It is compulsory for a cooperative society to get itself registered under the Cooperative Societies Act. After registration the cooperative organisation becomes a separate legal entity. It means the cooperative society is considered separate from its members.
- 3. 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.
- 4. Service Motive.** The formation of co-operatives is based on service motive rather than a profit motive. Its object is to serve their members and not to maximise profits. These societies provide different types of services to their members.
- 5. Equality of Voting Rights.** The main principle of co-operative society is 'one man one vote'. Irrespective management of a co-operative society is democratic. Important decisions are taken by majority.
- 6. Democratic Management.** The management of a co-operative society is based on democratic lines. A body of members is elected to conduct and control the business. This body is elected through 'one-man-one-vote system'. Members can give suggestions, opinions and problems.

7. Disposal of Surplus (Profit). The surplus arising out of year's working is not distributed among the members by way of dividend. A specified portion of the profits is transferred to Statutory Reserve Fund and then a fair rate of interest is paid on the capital subscribed by the members. The remaining profits are distributed equitably among the members according to the extent of the business transacted with it by each member.

Types of Cooperative Societies

Following are the main types of co-operative societies:

1. Consumers' co-operative societies
2. Co-operative credit societies
3. Producers co-operative societies
4. Marketing co-operative societies
5. Co-operative farming societies
6. Co-operative housing societies.

Merits of Cooperatives

The co-operative form of organisation offers the following advantages :

- (i) **Ease of Formation.** A co-operative society is a voluntary association and may be formed with a minimum of ten adult members. Its registration is very simple and can be done without much legal formalities.
- (ii) **Open Membership.** Membership in a co-operative organisation is open to all having a common interest. A person can become a member at any time he likes and can leave the society by returning his shares without affecting its continuity.
- (iii) **Democratic Management.** A co-operative society is managed in a democratic manner. It is based on the principle of one-man-one-vote. All members have equal rights and can have a voice in its management.
- (iv) **Limited Liability.** The liability of the members of a co-operative society is limited to the extent of capital contributed by them. They do not have to bear personal liability for the debts of the society.
- (v) **Economical Operations.** The operation of a co-operative society is quite economical due to elimination of middlemen and the voluntary services provided by its members.
- (vi) **Stability.** A co-operative society has a separate legal existence. It is not affected by the death, insolvency, lunacy or permanent incapacity of any of its members. It has a fairly stable life and continues to exist for a long period.
- (vii) **Government Support.** Government gives various kinds of help to co-operatives, such as loans at lower rates of interest and relief in taxes.
- (viii) **Promotion of Social Values.** The cooperative societies promote social justice and mutual cooperation. They promote self help, moral value among the members. They also help to prevent concentration of economic power in few hands.

Limitations of Cooperatives

Cooperative societies suffer from the following limitations :

- (i) **Limited Capital.** The cooperative organisation is formed by the people who have limited resources and there is no compulsion to buy more than one share by each member.
- (ii) **Inefficiency in Management.** 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 on a voluntary basis are generally not professionally equipped to handle the management functions effectively.
- (iii) **Lack of Motivation.** In cooperative organisation, there is no direct link between efforts and reward. Hence, members are not inclined to put their best efforts. There is no incentive for working efficiently.
- (iv) **Conflicts among Members.** The members are from different sections of society. They may have difference of opinion and if any member follows rigid attitude, it can lead to conflicts. Generally the selfish motive of members starts dominating and they forget the service motive.

5.5 JOINT STOCK COMPANY

Definition of Joint Stock Company

L.H. Haney has defined joint stock company as "voluntary association of individuals for the profits, having a capital divided into transferable shares, the ownership of which is the condition of membership".

According to Justice Lindley, "A company is 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."

Definitions of Company

"A company is an artificial person created by law, having a separate legal entity, with a perpetual succession and a common seal." —L.H. Haney

"A company is an association of many persons who contribute money or money's worth to common stock and employ it in some trade or business and who share the profits or losses arising therefrom." —James Stephenson

"A company is an artificial being, invisible, intangible and existing only in the eyes of law." —Chief Justice Marshall

Features of a Company

The most common features of a joint stock company may be stated as follows :

1. Incorporated Association. A company is an incorporated association. It comes into existence only after registration under the Companies Act.

2. Artificial Legal Person. A company has a legal personality and as such, it is regarded by law as an artificial legal person. A company has the right to acquire and dispose of the property. It can enter into contract with third parties in its own name. It can sue and be sued in its own name.

3. Separate Legal Entity. A company has a legal entity distinct from its members. It is an artificial person having an independent existence. The principle of a separate legal entity was established in the case of *Soloman Vs. Solomon and Company Limited (1897)*.

4. Common Seal. Since a company is an artificial person, it has no physical existence. The activities of the company are carried through a group of natural persons elected by its members (called directors). Every company must, therefore, have a common seal with its name engraved on it. Anyone acting on behalf of the company must use the common seal to bind the company.

5. Perpetual Succession. A company has continuous existence independent of its members. Death, insolvency, or change of members has no effect on the life of a company.

6. Limited Liability. The liability of the members of a company is limited. It is limited to the extent of 'capital agreed to be contributed'. Beyond that amount, the members cannot be personally held liable for payment of the company's debts.

7. Transferability of Shares. The capital of a company is divided into parts called shares. Normally, the shares of a company are freely transferable by its members. However, transferability is restricted in the case of private company.

8. Separation of Ownership and Control. The company form of business is owned by the shareholders. These shareholders elect their representatives who are called directors of the company. The directors manage and control the activities of the company by appointing professional experts.

Merits of a Company

The important advantages of a company organisation may be stated as follows :

(i) **Huge Financial Resources.** The biggest advantage of a company organisation is that it has the ability to collect large amounts of funds. This is because a company can raise capital by issuing shares to a large number of persons.

(ii) **Limited Liability.** Another advantage of the company form of organisation is the limited liability of members. With the liability of members limited to the value of their shares, a company is able to attract many people to invest in its shares. It is thus in a position to undertake business ventures involving risks.

- (iii) **Transferability of Shares.** A company permits its members to transfer their shares. Free transferability of shares provides liquidity to the members investment.
- (iv) **Durability and Stability.** A company is the only form of organisation which enjoys continuous existence and stability. The funds invested in a company by shareholders are not withdrawable until it is wound up. Also, any change in the company's membership does not affect its life.
- (v) **Efficient Management.** Company form of business has huge funds at its disposal. It can easily afford to hire professional experts to perform managerial and other activities of the organisation. The expert and specialised people improve the efficiency and working of company.
- (vi) **Growth and Expansion.** In company form of business there is more scope for growth and expansion. A company has large financial resources and their rate of profit is also high. They can easily use large amount of accrued or retained profit for expansion and growth.
- (vii) **Diffused Risk.** In a joint-stock company the risk is spread over a large number of shareholders. It reduces per capita risk. Whereas sole trader suffers all business risks alone and in a partnership firm, risk is divided only among the limited members.
- (viii) **Democratic Setup.** The management of a company functions on democratic line. It is managed and controlled by a board of directors who are duly elected in the annual general meeting of the company by the shareholders. So shareholders have a say in the management of the company.
- (ix) **Public Confidence.** A company enjoys great confidence and trust of the general people. Companies have to disclose the results of their activities and financial position in the annual reports. These reports are available to the public. It is on the basis of the annual reports and other information that investment is made in companies.

Limitations of a Company

A company organisation suffers from the following limitations :

- (i) **Complex Formation Procedure.** The registration of a company is a long-drawn process. A number of documents are to be prepared and filed.
- (ii) **Lack of Secrecy.** It is not possible for a company to keep its business secrets as its management and control is in the hands of many people and moreover its accounts and financial statements are to be published. As the business secrets cannot be maintained it adversely affects the profitability of the business.
- (iii) **Delay in Decision-making.** Red-tapism and bureaucracy do not permit quick decisions and prompt action. There is little scope for personal initiative and a sense of responsibility. Paid employees like to play safe and tend to shift responsibility.

- (iv) **Excessive Government Regulations.** A company is subject to government regulations at every stage of its working. A company has to file regular returns and statements of its activities with the Registrar. Filing returns and reports involving considerable time and money is the responsibility of the company. All this reduces flexibility in operations.
- (v) **Lack of Incentive.** The company is not managed by shareholders but by directors and other paid officials. Officials do not have investment in the company and also do not bear the risks. As such, they may not be as much motivated to safeguard the interests of the company as the shareholders.
- (vi) **Economic Oligarchy.** It is said that there is democratic set up in company form of business, but this democratic set up exists only on paper. In real practice, company is in the hands and control of few people, i.e., the directors. The directors have complete control over the company. These few people take all the decisions keeping in mind their personal interest and benefit, ignoring the interest of shareholders and the company.

5.6 PRIVATE AND PUBLIC COMPANIES

5.6.1 Definition of Private Limited Company

A private company means a company which :

- restricts the right of members to transfer its shares;
- has a minimum of 2 and a maximum of 200 members, excluding the present and past employees;
- does not invite public to subscribe to its share capital; and
- must have a minimum paid-up capital of Rs. 1 lakh or such higher amount which may be prescribed from time to time.

It is necessary for a private company to use the word *private limited* after its name. If a private company contravenes any of the aforesaid provisions, it ceases to be a private company and loses all the exemptions and privileges to which it is entitled.

5.6.2 Definition of Public Limited Company

A public company means a company which is not a private company. As per the Indian Companies Act, a public company is one which :

- has a minimum paid-up capital of Rs. 5 lakh or a higher amount which may be prescribed from time to time;
- has a minimum of 7 members and no limit on maximum members;
- has no restriction on transfer of shares; and
- is not prohibited from inviting the public to subscribe to its share capital or public deposits.

A private company which is a subsidiary of a public company is also treated as a public company.

TABLE 5.4 : Private Company vs. Public Company

| Basis | Private Company | Public Company |
|-----------------------------|---|---|
| 1. Number of Shareholders | There should be a minimum of two members and maximum fifty members. 2 to 500 | There should be a minimum of seven members but there is no limit on maximum number of members. |
| 2. Commencement of Business | It can start its business after getting the 'Certificate of Incorporation'. | It can start its business only after getting the certificate of commencement of business. |
| 3. Issue of Prospectus | It cannot issue a prospectus to invite the general public for purchase of its shares. | It must issue a prospectus or a statement in lieu of prospectus for inviting public for subscription of its shares. |
| 4. Allotment of Shares | It can allot its shares immediately after its incorporation. | It can only allot its shares when the amount of minimum subscription money is received. |
| 5. Transfer of Shares | There is restriction on the transfer of the shares of a private company. | Shares of a public company can be transferred to any third party. |
| 6. Number of Directors | There should be minimum two directors in a private company. | There should be at least three directors in case of public company. |
| 7. Name | Public Ltd. | Private Ltd. |
| 8. Articles of Association | It may adopt Table A given in the Companies Act. | It must prepare its own articles of association. |
| 9. Minimum Paid-up Capital | Five lakh rupees. | One lakh rupees. |
| 10. Index of Members | It must keep an index of members if number of members exceeds fifty. | It need not keep an index of members. |

PARTNERSHIP DEED

A partnership deed is an agreement between the partners of a firm that outlines the terms and conditions of partnership among the partners. A **partnership firm** is one of the popular types of organizations for starting a new business.

The smooth and successful running of a partnership firm requires a clear understanding among its partners regarding the various policies governing their partnership. The partnership deed serves this purpose. It specifies the various terms such as profit/loss sharing, salary, interest on capital, drawings, admission of a new partner, etc. in order to bring clarity to the partners.

Though issuing a partnership deed is not mandatory, but it's always better to enter into a partnership deed to avoid any possible disputes and litigation among the partners. The agreement can be made between two or more partners. It must be stamped and signed by all the partners.

The partnership deed contains the following details:

Business of the firm: Business to be undertaken by the partners of the firm.

Duration of Partnership: Whether the duration of the partnership firm, is for a limited period or for a specific project.

Sharing of profit/loss: Ratio of sharing profits & losses of the firm among partners.

Salary and commission: Details of the salary, and commission if any, payable to partners.

Capital contribution: Capital contribution to be made by each partner and the interest on said capital to be paid to partners.

Partner's Drawings: Policy regarding the drawings from the firm allowed to each partner and interest if any to be paid by partner, to the firm on such drawings.

Partner's Loan

Duties & Obligations of partners

Admission, Death & Retirement of partner

Accounts & Audit