

18. Business Organization (II): Partnership

Objectives

At the end of this chapter students should be able to define partnership as a form of business organization; describe the various types; give examples; state the terms for partnership agreement; identify the sources of capital and different sections of the balance-sheet of a partnership and finally state the advantages and disadvantages of partnership.

18.1 Introduction

Meaning or Definition

Partnership is the association of two or more people, usually with the common objective of making profit, through the pursuit of lawful business. The Partnership Act of 1890 defines it as:

The relation which subsists between persons carrying on a business in common with a view of profit.

The persons forming the association are called *partners*. Usually, the number of partners should not be fewer than two and not more than twenty. In the case of banking, the number should not exceed ten; while in the case of accountancy, solicitorship, and members of a stock exchange, the number could exceed twenty provided all members are professionally qualified. Where the number exceeds twenty, except in cases mentioned above, the association must register under the Companies and Allied Matters Acts of 1990.

18.2 Types of Partners

- (i) *Ordinary or general or active partner*: As this title suggests, he is actively involved in the administration of the partnership. In essence, he has unlimited liability for the debts of the firm. Even where other partners opt for limited liability, there must always be at least one general or active partner for the purpose of bearing the liability of the partnership to an unlimited extent.
- (ii) *Limited or special partner*: Again, as his name indicates, this partner has a limited liability in the partnership; and the liability is strictly limited to the amount of capital which he brings into the partnership. He takes no active part in the administration of the partnership.

He contributes his own capital; he is entitled to his share of profit and could inspect books of accounts, but he is not actively involved in the management of the partnership. A limited partnership must be registered with the registrar of joint stock companies.
- (iii) *Nominal partner*: This partner brings in no capital to the firm, but he brings in his name which must be capable of according the firm a substantial social prestige and respectability. He does not share out of the profit, and since he contributes no capital, he is liable to anybody who assumes him a partner. This type of partner is also known as quasi partner.
- (iv) *Sleeping partner*: He is also referred to as “dormant partner”™. He puts in capital into

the partnership and receives his share of profit, but he takes no active in the management and administration of the firm. To the public, he is unconnected with partnership. He is dormant. He is also known as “silent” partner.

- (v) *Secret partner*: He contributes capital and takes his share of profit, but he is only involved in the activities of the firm discreetly (under cover). He is unknown as a partner to the public. This is the posture usually assumed by those who want to make their membership of a partnership a secret.

18.3 Formation and Agreement

There are no formalities at all in the formation of a partnership. Partners could formally or informally agree among themselves as they please. However, in order to avert future controversies, partnership agreements usually follow certain laid-down patterns known as *Deed of Partnership*. The deeds of partnership are otherwise referred to as the *Article of Partnership* and they set out the rights, powers, and duties of partners.

18.3.1 Deed of Partnership

The following points must be settled by deed of partnership which then become a written agreement:

- (i) Names of partners and name of firm, if both are different;
- (ii) Nature of business;
- (iii) Duties of partners;
- (iv) Duration of partnership;
- (v) Amount of capital contribution per partner;
- (vi) Rate of interest payable on loans or drawings;
- (vii) Ratio of sharing profits and losses;
- (viii) Whether or not interest should be paid on capital;
- (ix) Arrangements in respect of partners’ drawings for private use;
- (x) Amount of partners’ salaries (if any);
- (xi) The form of accounts keeping and audit; where books of accounts are to be kept;
- (xii) Provision for settling of disputes – through arbitration;
- (xiii) Arrangement for ascertaining partners’ share of business at death or retirement;
- (xiv) Conditions for the admission of new partners.
- (xv) Conditions for dissolution
- (xvi) Rights of partners. Where there is no clear evidence of any agreement to the contrary, the provisions of the Partnership Act of 1890 will apply.

18.3.2 Partnership Act 1890

Legal entity: In Nigerian partnership, the partners have no separate legal entities from the partnership. In fact, the individual partners are liable for all the responsibilities of the partnership.

Business name: Like any other business, partnership is subject to the Registration of Business Names Act of 1916 which has the following provisions:

- (i) The firm, persons or individuals who carry on business in a name must register the name with the registrar of companies within fourteen days of commencing business.

- (ii) The name which the partners bear in business is not the same thing as surnames, initials or appellations.
- (iii) The name must not be similar to a previously registered name.
- (iv) The name must not be deceptive, e.g. to give a false impression that it is a government concern. For this reason, names like “State”™, “Government”™, “National”™, “Royal”™, “Trust”™, “Imperial”™, and “Chamber of Commerce”™ must not be used.
- (v) Change of name must similarly be forwarded to the Registrar of Business Names.
- (vi) The certificate of registration issued by the registrar must be shown in a conspicuous place – the office of the business.
- (vii) All letters, cards and other commercial documents of the firm must carry the full names of the partners.
- (viii) Other information: The nature and particulars of the business, as well as of the individual partners, must be notified to the Registrar of Companies.

The following penalties might result from failure to comply with the provisions of the Business Names Registration Act:

1. The business organisation would be unable to enforce its rights, while innocent parties could enforce their rights against the unregistered business.
2. The business could be fined an amount of N20.00 per day for the period of non-conformity.

18.3.3 The Powers of a Partner

A partner has the following powers:

- (i) He can do anything that is necessary for the efficient running of the partnership.
- (ii) Wherever he has power to act, his acts bind the other partners.
- (iii) In a trading business, he can borrow money on behalf of the other partners.
- (iv) He can offer partnership property as security.
- (v) He can draw cheques or any other negotiable instruments on behalf of the partnership.
- (vi) He has power over employment and dismissal of members of staff.
- (vii) He can sue and defend on behalf of the partnership.

18.3.4 The liabilities of the partner

If the partners have their rights and powers, they equally have their liabilities:

- (i) A partner is jointly liable with other members of the firm for debts and obligations.
- (ii) Upon his death, the estate of a partner is liable for his unpaid debts.
- (iii) The partners are jointly and severally liable for civil wrongs committed during the life of the partnership firm.
- (iv) A partner is liable to a refund of all personal gains and profits made in the course of partnership business.
- (v) Even after the partner has left, he could still be liable with others for the debts and obligations of the firm if: (a) has not or the firm has not taken steps to announce through the mass media that he has ceased to be a member; (b) he acts as if he were still a member; (c) by his conduct and appearance he is regarded as being a member.

Just as he has the right to equal share in profits, he is also liable to equal share in losses in

the absence of any provision to the contrary.

However, the following are limits to the liabilities of partner:

- (i) A partner is not liable for debts incurred or wrong committed before he joins the partnership.
- (ii) A partner is not liable for the debts sustained or any wrongdoings of his partner after his retirement notice is duly served on the partnership and its customers; and the same is published in the official Gazette of the Federal Government.
- (iii) The other partners are free from the debts and obligations of the partnership when a creditor sues and obtains judgement against an individual or specific partner for a partnership debt. The creditor cannot then proceed to sue the other partners even if the sued partner could not get the money to pay.
- (iv) If by agreement of both partners and creditors the other partner is deemed free from the debts so incurred while he was still a partner.

18.4 Sources of Capital

Introduction: Obtaining more capital is one of the strong reasons for forming a partnership. Capital is needed to start or run a business including a partnership and basically it comes from the following sources.

- (i) **Partners contribution:** The money to start or finance partnership business is contributed by the partners. The capital contributed by the partners need not be equal. While some partners may contribute more others may contribute less: that is why profits may be shared according to the ratio of capital contributed by the partners.

The capital contributed by the partners could be from their past savings in their previous employment/engagements. It could be assistance from members of their families or good friends.

- (ii) **Loans:** Another source of capital available to the partnership is loan. A partnership can borrow to start its business and may also borrow to sustain its business. The loan can come from wealthy individuals or relations who are willing to lend the partners some amount of money which may be returned at a future date with or without interest. Partnership as a business organisation finds it difficult to borrow from the bank because of inability to provide collateral for the loan, unlike the limited liability company. However, a bank may decide to lend to partnership on short-term basis on the personal merit of the individual partners after two well-known customers of the bank have agreed to stand surety for them, in which case the loan must be returned to the bank within two years with or without interest.
- (iii) **Credit purchase:** An existing partnership that lacks finance may like to buy its goods or obtain services on credit from its customers with a promise to pay later. Through this means, goods and services will be available to the partnership for sale and to enjoy. In this way the need for funds is realized.
- (iv) **Ploughing back profit:** A partnership can finance its business expansion through internally generated resources, such as reinvesting its undivided profit. Members of a partnership may decide to share only a part of the profit earned within a period of time and the rest of the entire profit retained in the partnership business or expansion.
- (v) **Depreciation fund:** Money accumulated for the replacement of worn-out assets, eg. plant

and machinery can serve as a ready source of fund for the partnership to invest in business pending the time the assets will be replaced.

- (vi) **Partner's current account:** This account is made up of accumulation of all the entitlements of each of the partners minus any drawings, plus interest payable (if any) on such drawings. That is, any residual funds left in the partnership to the credit of the partners apart from their contributed capital is credited to the partner's current account and is regarded as part of the funds being utilised by the partnership.

18.5 Advantages and Disadvantages of Partnership

(a) Advantages

The advantages could be considered in comparison with the sole trader and the joint stock company. When compared with the sole trader, partnership has the following advantages:

- (i) *Larger capital resources:* Partnership has a greater source of capital contributed by the partners than the single capital of a sole trader.
- (ii) *Greater human resources:* Partnership is richer in management personnel of diversified talents and expertise.
- (iii) *Specialization of management:* Specialization is more easily attainable in diversified expertise. One partner may specialise in finance, the other in production, and another in marketing, etc. Such experts are common in law, medicine and accountancy. There are wider scopes of discussion and consultation among partners with the consequent cross-fertilization of ideas.
- (iv) *A larger organization:* With larger capital and specialized manpower, a bigger business organization is more easily attainable than with the sole proprietorship.
- (v) *Simple formation formalities:* The process of formation is simple and relatively inexpensive.
- (vi) *No limitation by its objectives:* Unlike a company which could be limited by the objectives in its memorandum of association, once formed, a partnership is capable of carrying out any kind of business on which the partners are agreed.
- (vii) *Management by caution:* Consequent upon the implication of unlimited liability, the management of partnership always exercises great caution. This in effect safeguards the interests of the creditors.
- (viii) *Privacy:* Partnership, by not publishing its accounts (unlike the public companies), does not unduly expose its books of accounts to its competitors.
- (ix) *Good management and staff relationship:* Personal contacts between partners and their employees are easily attainable. This promotes good working human relationship within the entire organization.
- (x) *Greater care for high reputation:* Since partnership is built around the personalities of the partners, great care is taken to uphold high integrity and goodwill.
- (xi) *Suitability to most professions:* Partnership is one form of business concern that is suitable for most professional practices. Law, medicine, accountancy and insurance brokerage are few of such professions that are popularly practised on the basis of partnership.
- (xii) *Minimal capital needs:* Partnerships, unlike public or joint stock companies, do not require a large amount of capital. This is why it is easily handy for most professional people to form

partnership for the practice of their professions.

(b) Disadvantages

- (i) *Limited sources of capital:* Available amount of ready capital is limited to what could be contributed at most by twenty members. Unlike public companies, partnership is not able to attract large amounts of loans from commercial banks, because of the limited security that partnership can provide. Partnership is not even qualified to borrow from development banks like the Nigerian Bank for Commerce and Industry (NBC) or the Nigerian Industrial Development Bank (NIDB).
- (ii) *Lack of perpetual existence:* Unlike in a public company, and unless it is otherwise provided for in the partnership deed, the death or resignation of a partner may result in the dissolution of the partnership.
- (iii) *Loss of capital resulting from loss of a partner:* The death or resignation of a partner may lead to the withdrawal of that partner's capital. This may have an adverse effect on the financial position of the partnership; even when it has been otherwise provided for that the death or resignation of a partner should not lead to a dissolution.
- (iv) *Non-legal entity and ownership of property:* Since partnership has no legal existence, the ownership of its property is vested in the partners jointly and severally as trustees, and not in the partnership; the death of a partner can adversely affect the growth of the partnership.
- (v) *Unlimited liability:* Liability to an unlimited extent is the lot of the active or ordinary partners. The personal property of such members could be forfeited to meet the debts of the partnership.
- (vi) *Difficulty in admitting new partners:* The admission of a new partner may not be easy as all the partners must agree or find the new partner acceptable.

18.6 The Balance-sheet of a Partnership

Basically, the format of a balance-sheet is the same for all types of business unit or organization. However, the contents of such balance-sheet will depend on the nature of a particular organization and its sources of capital.

Consequent upon this, the items that are usually accumulated in the partners' current accounts are as follows:

- (i) Any salaries payable or paid to partners.
- (ii) Any commissions payable or paid to partners.
- (iii) Any interests receivable on partners' capital.
- (iv) Any interest paid or payable on loans from partners.
- (v) Any share of profits among partners.

The current account is usually stated as a figure on the balance-sheet.

Table 18.1 The Balance-sheet of Light and Day in Partnership as at December 31, 2003

Long-term Liabilities			Assets			
Capital Accounts			Fixed Assets			
				at cost	Depreciation	W.D. Value
	₦	₦		₦	₦	₦
'L'	10,000		Land &	30,000		30,000
'D'	20,000	30,000	Building			
			Machinery	6,000	2,000	4,000
Current Accounts			less			
'L'	2,200		Depreciation	5,000	2,000	3,000
'D'	4,000	5,100	Delivery Van	41,000		37,000
Long-term Loans			Current Assets			4,000
'L'	2,000		Stock	3,500		
'D'	4,000	6,000	Debtors	1,500		
		41,100	Bills receivable	1,200		
			Pre-payment	800		
			Cash	<u>1,000</u>		<u>8,000</u>
Current Liabilities						
Creditors	2,900					
Bills payable	1,000	3,900				
		45,000				45,000

18.7 Dissolution of Partnership

A partnership is dissolved in any of the following circumstances:

- When it has run its normal period, i.e. at the expiration of the period for which it was formed.
- When it has achieved the objectives for which it was formed, e.g. for exploration of mineral resources that are now exhausted.
- By the mutual agreement of the partners, i.e. when the partners have all agreed to terminate the firm.
- When a partner gives notice that the partnership should be dissolved.
- When a partner is bankrupt or dead.
- When the occurrence of an event renders the partnership unlawful to continue.
- When the court so decides:

1. for reasons of incapacity, misconduct, or insanity of a member;
2. for reason of inability of the partnership to continue on a profitable basis;
3. on any other equitable grounds.

Summary

â€¢ *Definition:* Partnership is an association of two to twenty people who engage in lawful business activities for profit. Lawyers, accountants, architects, and a host of professional firms are good examples of partnership.

â€¢ Partnership can be formal, in which case it is governed by Deed of Partnership, as provided by the Partnership Act 1890; or it can be informal in which case the partners have their own partnership agreement.

â€¢ Some of the salient features of partnership are:

- (i) A partner can bind other partners in a contract;
- (ii) Liability of partner is not limited.
- (iii) *Rights of partners:* these are many and include right to demand for reimbursement for expenses incurred rightly on behalf of the partnership.

â€¢ Types of partners:

- (i) General or active – this partner actively engages in the day-to-day partnership business.
- (ii) A limited partner has liability in the partnership limited to the extent of his own capital. Others are *sleeping, silent, and secret*, as the titles connote.

â€¢ *Advantages:* One of the most important merits is the pooling together of capital and manpower resources of partners, and this makes it superior to the sole proprietorship, among other points.

â€¢ *Disadvantages:* Lack of legal entity, and inability to go to the public capital market to raise finance are some of the demerits of partnerships.

â€¢ *The nature of the accounts:* this is characterized by

- (i) separation of each partner's capital and current accounts;
- (ii) share of profit on an agreed ratio;
- (iii) payment of tax, not on partnership profit, but on the share of profits going to each of the partners;
- (iv) while share of profits could be added to the current account of each partner, losses are also deductible from the current account and when that is exhausted such losses could be made good by deduction from the capital account of the partner.

Revision Questions

A. Essay Questions

1. (a) What is a "Deed of Partnership"? (2 marks)
- (b) State Six contents of a Deed of Partnership. (12 marks)
- (c) Give Three rights of a partner. (6 marks)

(WASSCE)

2. (a) Give FIVE major features of general or ordinary partnership. (10 marks)

- (b) List and explain sources of fund available to partnership business. (8 marks)
- (c) Write a short note on either a quasi partner or a nominal partner (2 marks)
- 3. State FIVE powers of a partner.
- 4. What are FOUR liabilities of a partnership?

(SSCE 1999)
- 5. (a) Give FOUR major sources of finance to a partnership.
(b) Discuss THREE key areas of limitation to these sources of finance.

B. Objective Questions

- 1. An agreement between two or more persons which is intended to be enforceable by law is termed:
 - A. Agency
 - B. Contract
 - C. Hire-purchase
 - D. Partnership
 - E. Sale of goods

(NECO 2002)
- 2. An existing partnership is dissolved if it
 - A. is registered under a trade name
 - B. has been registered for over ten years
 - C. has no limited partner
 - D. admits a new partner

(WASSCE 2000)
- 3. A partnership business will not raise capital through
 - A. contributions
 - B. credit purchases
 - C. debentures
 - D. retained earnings

(WASSCE 1999)
- 4. Which of the following does not lead to the dissolution of a deed of partnership?
 - A. Absence of a deed of partnership
 - B. Withdrawal of a partner
 - C. Incapacity of any of the partners
 - D. Completion of contractual term

(WASSCE 2001)
- 5. Which body of these people has NOT been granted an exception to have as many partners as are necessary by the company's Act of 1967?
 - A. Accountants
 - B. Bankers
 - C. Brokers
 - D. Jobbers
- 6. In partnership business the maximum number of person for its formation is

- A. five
- B. fifteen
- C. ten
- D. twenty

(NECO 2001)

7. A partnership formed for banking business is made up of
- A. 2–10 members
 - B. 2–20 members
 - C. 2–30 members
 - D. 2–40 members
 - E. 2–50 members

(SSCE 1989)

8. Which of the following statements is true of limited partnership?
- A. Every member is a limited partner
 - B. All members are general partners
 - C. All members have limited liability
 - D. There is at least one ordinary partner
 - E. Limited and ordinary partners must be equal in number

(SSCE 1999)

9. Which of the following is not required for the dissolution of a partnership?
- A. Order from the Registrar of Companies
 - B. Mutual consent of the partners
 - C. One partner giving intention to dissolve
 - D. Termination of venture
 - E. Expiration of partnership deed

(SSCE 2001)

10. One of these points may not necessarily be carried in partnership deeds
- A. Capital contribution per partner
 - B. Partners' salaries (if any)
 - C. Name of successor in case of a partner's death
 - D. Ascertaining partner's business share at death or retirement

Project

Look for an example of a partnership in your locality and describe its setup.