CHAPTER 2

FORMS OF BUSINESS ORGANISATION

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- identify different forms of business organisation;
- explain features, merits and limitations of different forms of business organisations;
- distinguish between various forms of organisations; and
- discuss the factors determining choice of an appropriate form of business organisation.

Neha, a bright final year student was waiting for her results to be declared. While at home she decided to put her free time to use. Having an aptitude for painting, she tried her hand at decorating clay pots and bowls with designs. She was excited at the praise showered on her by her friends and acquaintances on her work. She even managed to sell a few pieces of unique hand pottery from her home to people living in and around her colony. Operating from home, she was able to save on rental payments. She gained a lot of popularity by word of mouth publicity as a sole proprietor. She further perfected her skills of painting pottery and created new motifs and designs. All this generated great interest among her customers and provided a boost to the demand for her products. By the end of summer, she found that she had been able to make a profit of Rs. 2500 from her paltry investment in colours, pottery and drawing sheets. She felt motivated to take up this work as a career. She has, therefore, decided to set up her own artwork business. She can continue running the business on her own as a sole proprietor, but she needs more money for doing business on a larger scale. Her father has suggested that she should form a partnership with her cousin to meet the need for additional funds and for sharing the responsibilities and risks. Side by side, he is of the opinion that it is possible that the business might grow further and may require the formation of a company. She is in a fix as to what form of business organisation she should go in for?

2.1 Introduction

If one is planning to start a business or is interested in expanding an existing one, an important decision relates to the choice of the form of organisation. The most appropriate form is determined by weighing the advantages and disadvantages of each type of organisation against one's own requirements.

Various forms of business organisations from which one can choose the right one include:

(a) Sole proprietorship,

(b) Joint Hindu family business,

(c) Partnership,

(d) Cooperative societies, and

(e) Joint stock company.

Let us start our discussion with sole proprietorship — the simplest form of business organisation, and then move on to analysing more complex forms of organisations.

2.2 Sole Proprietorship

Do you often go in the evenings to buy registers, pens, chart papers, etc., from a small neighbourhood stationery store? Well, in all probability in the course of your transactions, you have interacted with a sole proprietor.

Sole proprietorship is a popular form of business organisation and is

the most suitable form for small businesses, especially in their initial years of operation. Sole proprietorship refers to a form of business organisation which is owned, managed and controlled by an individual who is the recipient of all profits and bearer of all risks. This is evident from the term itself. The word "sole" implies "only", and "proprietor" refers to "owner". Hence, a sole proprietor is the one who is the *only owner* of a business.

This form of business is particularly common in areas of personalised services such as beauty parlours, hair saloons and small scale activities like running a retail shop in a locality.

> Sole trader is a type of business unit where a 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 individual 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*

Features

Salient characteristics of the sole proprietorship form of organisation are as follows:

(i) Formation and closure: There is no separate law that governs sole proprietorship. Hardly any legal formalities are required to start a sole proprietary business, though in some cases one may require a license. Closure of the business can also be done easily. Thus, there is ease in formation as well as closure of business.

(ii) Liability: Sole proprietors have unlimited liability. This implies that the owner is personally responsible for payment of debts in case the assets of the business are not sufficient to meet all the debts. As such the owner's personal possessions such as his/her personal car and other assets could be sold for repaying the debt. Suppose the total outside liabilities of XYZ dry cleaner, a sole proprietorship firm, are Rs. 80,000 at the time of dissolution, but its assets are Rs. 60,000 only. In such a situation the proprietor will have to bring in Rs. 20,000 from her personal sources even if she has to sell her personal property to repay the firm's debts.

(iii) Sole risk bearer and profit recipient: The risk of failure of business is borne all alone by the sole proprietor. However, if the business is successful, the proprietor enjoys all the benefits. He receives all the business profits which become a direct reward for his risk bearing.

(iv) Control: The right to run the business and make all decisions lies

absolutely with the sole proprietor. He can carry out his plans without any interference from others.

(v) No separate entity: In the eyes of the law, no distinction is made between the sole trader and his business, as business does not have an identity separate from the owner. The owner is, therefore, held responsible for all the activities of the business.

(vi) Lack of business continuity: The sale proprietorship business is owned and controlled by one person, therefore death, insanity, imprisonment, physical ailment or bankruptcy of the sole proprietor will have a direct and detrimental effect on the business and may even cause closure of the business.

Merits

Sole proprietorship offers many advantages. Some of the important ones are as follows:

(i) Quick decision making: A sole proprietor enjoys considerable degree of freedom in making business decisions. Further the decision making is prompt because there is no need to consult others. This may lead to timely capitalisation of market opportunities as and when they arise.

(ii) Confidentiality of information: Sole decision making authority enables the proprietor to keep all the information related to business operations confidential and maintain

A Refreshing Start: Coca Cola Owes its Origin to a Sole Proprietor!

The product that has given the world its best-known taste was born in Atlanta, Georgia, on May 8, 1886. Dr. John Stith Pemberton, a local pharmacist, produced the syrup for Coca-Cola®, and carried a jug of the new product down the street to Jacobs' Pharmacy, where it was sampled, pronounced "excellent" and placed on sale for five cents a glass as a soda fountain drink. Dr. Pemberton never realised the potential of the beverage he created. He gradually sold portions of his business to various partners and, just prior to his death in 1888, sold his remaining interest in Coca-Cola to Asa G. Candler. An Atlantan with great business acumen, Mr. Candler proceeded to buy additional business rights and acquire complete control.

On May 1, 1889, Asa Candler published a full-page advertisement in *The Atlanta Journal*, proclaiming his wholesale and retail drug business as ***"sole proprietors of Coca-Cola ... Delicious. Refreshing. Exhilarating. Invigorating."*** Sole ownership, which Mr. Candler did not actually achieve until 1891, needed an investment of $ 2,300.

It was only in 1892 that Mr. Candler formed a company called The Coca-Cola Corporation.

Source: *Website of Coca Cola company.*

secrecy. A sole trader is also not bound by law to publish firm's accounts.

(iii) Direct incentive: A sole proprietor directly reaps the benefits of his/her efforts as he/she is the sole recipient of all the profit. The need to share profits does not arise as he/she is the single owner. This provides maximum incentive to the sole trader to work hard.

(iv) Sense of accomplishment: There is a personal satisfaction involved in working for oneself. The knowledge that one is responsible for the success of the business not only contributes to self-satisfaction but also instils in the individual a sense of accomplishment and confidence in one's abilities.

(v) Ease of formation and closure: An important merit of sole proprietorship is the possibility of entering into business with minimal legal formalities. There is no separate law that governs sole proprietorship. As sole proprietorship is the least regulated form of business, it is easy to start and close the business as per the wish of the owner.

Limitations

Notwithstanding various advantages, the sole proprietorship form of organisation is not free from limitations. Some of the major limitations of sole proprietorship are as follows:

(i) Limited resources: Resources of a sole proprietor are limited to his/her personal savings and borrowings from others. Banks and other lending institutions may hesitate to extend a long term loan to a sole proprietor. Lack of resources is one of the major reasons why the size of the business rarely grows much and generally remains small.

(ii) Limited life of a business concern: The sole proprietorship business is owned and controlled by one person, so death, insanity, imprisonment, physical ailment or bankruptcy of a proprietor affects the business and can lead to its closure.

(iii) Unlimited liability: A major disadvantage of sole proprietorship is that the owner has unlimited liability. If the business fails, the creditors can recover their dues not merely from the business assets, but also from the personal assets of the proprietor. A poor decision or an unfavourable circumstance can create serious financial burden on the owner. That is why a sole proprietor is less inclined to take risks in the form of innovation or expansion.

(iv) Limited managerial ability: The owner has to assume the responsibility of varied managerial tasks such as purchasing, selling, financing, etc. It is rare to find an individual who excels in all these areas. Thus decision making may not be balanced in all the cases. Also, due to limited resources, sole proprietor may not be able to employ and retain talented and ambitious employees.

Though sole proprietorship suffers from various shortcomings, many

entrepreneurs opt for this form of organisation because of its inherent advantages. It requires less amount of capital. It is best suited for businesses which are carried out on a small scale and where customers demand personalised services.

2.3 Joint Hindu Family Business

Joint Hindu family business is a specific form of business organisation found only in India. It is one of the oldest forms of business organisation in the country. It refers to a form of organisation wherein the business is owned and carried on by the members of the Hindu Undivided Family (HUF). It is governed by the Hindu Law. The basis of membership in the business is birth in a particular family and three successive generations can be members in the business.

The business is controlled by the head of the family who is the eldest member and is called *karta*. All members have equal ownership right over the property of an ancestor and they are known as *co-parceners*.

Features

The following points highlight the essential characteristics of the joint Hindu family business.

(i) Formation: For a joint Hindu family business, there should be at least two members in the family and ancestral property to be inherited by them. The business does not require any agreement as membership is by birth. It is governed by the Hindu Succession Act, 1956.

(ii) Liability: The liability of all members except the *karta* is limited to their share of co-parcenery property of the business. The *karta*, however, has unlimited liability.

(iii) Control: The control of the family business lies with the *karta*. He takes all the decisions and is authorised to manage the business. His decisions are binding on the other members.

(iv) Continuity: The business continues even after the death of the *karta* as the next eldest member takes up the position of *karta*, leaving the business stable. The business can,

Gender Equality in the Joint Hindu Family a Reality

According to the Hindu Succession (Amendment) Act, 2005, the daughter of a coparcener of a Joint Hindu Family shall, by birth, become a coparcener. At the time of partition of such a 'Joint Hindu Family' the coparcenary property shall be equally divided to all the coparceners irrespective of their gender (male or female). The eldest member (male or female) of 'Joint Hindu Family' shall become *Karta*. Married daughter has equal rights in property of a Joint Hindu Family.

however, be terminated with the mutual consent of the members.

(v) Minor Members: The inclusion of an individual into the business occurs due to birth in a Hindu Undivided Family. Hence, minors can also be members of the business.

Merits

The advantages of the joint Hindu family business are as follows:

(i) Effective control: The *karta* has absolute decision making power. This avoids conflicts among members as no one can interfere with his right to decide. This also leads to prompt and flexible decision making.

(ii) Continued business existence: The death of the *karta* will not affect the business as the next eldest member will then take up the position. Hence, operations are not terminated and continuity of business is not threatened.

(iii) Limited liability of members: The liability of all the co-parceners except the *karta* is limited to their share in the business, and consequently their risk is well-defined and precise.

(iv) Increased loyalty and cooperation: Since the business is run by the members of a family, there is a greater sense of loyalty towards one other. Pride in the growth of business is linked to the achievements of the family. This helps in securing better cooperation from all the members.

Limitation

The following are some of the limitations of a joint Hindu family business.

(i) Limited resources: The joint Hindu family business faces the problem of limited capital as it depends mainly on ancestral property. This limits the scope for expansion of business.

(ii) Unlimited liability of *karta*: The *karta* is burdened not only with the responsibility of decision making and management of business, but also suffers from the disadvantage of having unlimited liability. His personal property can be used to repay business debts.

(iii) Dominance of *karta*: The *karta* individually manages the business which may at times not be acceptable to other members. This may cause conflict amongst them and may even lead to break down of the family unit.

(iv) Limited managerial skills: Since the *karta* cannot be an expert in all areas of management, the business may suffer as a result of his unwise decisions. His inability to decide effectively may result into poor profits or even losses for the organisation.

The joint Hindu family business is on the decline because of the diminishing number of joint Hindu families in the country.

2.4 Partnership

The inherent disadvantage of the sole proprietorship in financing and managing an expanding business paved the way for partnership as a viable option. Partnership serves as an answer to the needs of greater capital investment, varied skills and sharing of risks.

> Partnership is the relation between persons competent to make contracts who have agreed to carry on a lawful business in common with a view to private gain.
>
> *L H Haney*
>
> Partnership is the relation which subsists between persons who have agreed to combine their property, labour or skill in some business and to share the profits therefrom between them.
>
> *The Indian Contract Act* 1872

The Indian Partnership Act, 1932 defines partnership as "the relation between persons who have agreed to share the profit of the business carried on by all or any one of them acting for all."

Features

Definitions given above point to the following major characteristics of the partnership form of business organisation.

(i) Formation: The partnership form of business organisation is governed by the Indian Partnership Act, 1932. It comes into existence through a legal agreement wherein the terms and conditions governing the relationship among the partners, sharing of profits and losses and the manner of conducting the business are specified. It may be pointed out that the business must be lawful and run with the motive of profit. Thus, two people coming together for charitable purposes will not constitute a partnership.

(ii) Liability: The partners of a firm have unlimited liability. Personal assets may be used for repaying debts in case the business assets are insufficient. Further, the partners are jointly and individually liable for payment of debts. Jointly, all the partners are responsible for the debts and they contribute in proportion to their share in business and as such are liable to that extent. Individually too, each partner can be held responsible repaying the debts of the business. However, such a partner can later recover from other partners an amount of money equivalent to the shares in liability defined as per the partnership agreement.

(iii) Risk bearing: The partners bear the risks involved in running a business as a team. The reward comes in the form of profits which are shared by the partners in an agreed ratio. However, they also share losses in the same ratio in the event of the firm incurring losses.

(iv) Decision making and control: The partners share amongst themselves the responsibility of decision making and control of day to day activities. Decisions are generally taken with mutual consent. Thus, the activities of a partnership firm are managed through the joint efforts of all the partners.

(v) Continuity: Partnership is characterised by lack of continuity of business since the death, retirement, insolvency or insanity of any partner can bring an end to the business. However, the remaining partners may if they so desire continue the business on the basis of a new agreement.

(vi) Number of Partners: The minimum number of partners needed to start a partnership firm is two. According to section 464 of the Companies Act 2013, maximum number of partners in a partnership firm can be 100, subject to the number prescribed by the government. As per Rule 10 of The Companies (miscelleneous) Rules 2014, at present the maximum number of members can be 50.

(vii) Mutual agency: The definition of partnership highlights the fact that it is a business carried on by all or any one of the partners acting for all. In other words, every partner is both an agent and a principal. He is an agent of other partners as he represents them and thereby binds them through his acts. He is a principal as he too can be bound by the acts of other partners.

Merits

The following points describe the advantages of a partnership firm.

(i) Ease of formation and closure: A partnership firm can be formed easily by putting an agreement between the prospective partners into place whereby they agree to carryout the business of the firm and share risks. There is no compulsion with respect to registration of the firm. Closure of the firm too is an easy task.

(ii) 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.

(iii) More funds: 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 needed.

(iv) 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.

(v) 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.

Limitations

A partnership firm of business organisation suffers from the following limitations:

(i) Unlimited liability: Partners are liable to repay debts even from their personal resources in case the business assets are not sufficient to meet its debts. The liability of partners is both joint and several which may prove to be a drawback for those partners who have greater personal wealth. They will have to repay the entire debt in case the other partners are unable to do so.

(ii) Limited resources: There is a restriction on the number of partners, and hence contribution in terms of capital investment is usually not sufficient to support large scale business operations. As a result, partnership firms face problems in expansion beyond a certain size.

(iii) Possibility of conflicts: Partnership is run by a group of persons wherein decision making authority is shared. Difference in opinion on some issues may lead to disputes between partners. Further, decisions of one partner are binding on other partners. Thus an unwise decision by some one may result in financial ruin for all others. In case a partner desires to leave the firm, this can result in termination of partnership as there is a restriction on transfer of ownership.

(iv) Lack of continuity: Partnership comes to an end with the death, retirement, insolvency or lunacy of any partner. It may result in lack of continuity. However, the remaining partners can enter into a fresh agreement and continue to run the business.

(v) Lack of public confidence: A partnership firm is not legally required to publish its financial reports or make other related information public. It is, therefore, difficult for any member of the public to ascertain the true financial status of a partnership firm. As a result, the confidence of the public in partnership firms is generally low.

2.4.1 Types of Partners

A partnership firm can have different types of partners with different roles and liabilities. An understanding of these types is important for a clear understanding of their rights and responsibilities. These are described as follows:

(i) Active partner: An active partner is one who contributes capital, participates in the management of the firm, shares its profits and losses, and is liable to an unlimited extent to the creditors of the firm. These partners take actual part in carrying out business of the firm on behalf of other partners.

(ii) Sleeping or dormant partner: Partners who do not take part in the day to day activities of the business are called sleeping partners. A sleeping partner, however, contributes capital to the firm, shares its profits and losses, and has unlimited liability.

(iii) Secret partner: A secret partner is one whose association with the firm is unknown to the general public. Other than this distinct feature, in all other aspects he is like the rest of the partners. He contributes to the capital of the firm, takes part in the management, shares its profits and losses, and has unlimited liability towards the creditors.

(iv) Nominal partner: A nominal partner is one who allows the use of his/her name by a firm, but does not contribute to its capital. He/she does not take active part in managing the firm, does not share its profit or losses but is liable, like other partners, to the third parties, for the repayments of the firm's debts.

(v) Partner by estoppel: A person is considered a partner by estoppel if, through his/her own initiative, conduct or behaviour, he/she gives an impression to others that he/she is a partner of the firm. Such partners are held liable for the debts of the firm because in the eyes of the third party they are considered partners, even though they do not contribute capital or take part in its management. Suppose Rani is a friend of Seema who is a partner in a software firm — Simplex Solutions. On Seema's request, Rani accompanies her to a business meeting with Mohan Softwares and actively participates in the negotiation process for a business deal and gives the impression that she

Table 2.1 Types of Partners

Type	Capital contribution	Management	Share in profits/ losses	Liability
Active partner	Contributes capital	Participates in management	Shares profits/ losses	Unlimited liability
Sleeping or dormant partner	Contributes capital	Does not participate in management	Shares profits/ losses	Unlimited liability
Secret partner	Contributes capital	Participates in management, but secretly	Shares profits/ losses	Unlimited liability
Nominal partner	Does not contribute capital	Does not participate in management	Generally does not share profits/ losses	Unlimited liability
Partner by estoppel	Does not contribute capital	Does not participate in management	Does not share profits/ losses	Unlimited liability
Partner by holding out	Does not contribute capital	Does not participate in management	Does not share profits/ losses	Unlimited liability

Minor as a Partner

Partnership is based on legal contract between two persons who agree to share the profits or losses of a business carried on by them. As such a minor is incompetent to enter into a valid contract with others, he cannot become a partner in any firm. However, a minor can be admitted to the benefits of a partnership firm with the mutual consent of all other partners. In such cases, his liability will be limited to the extent of the capital contributed by him and in the firm. He will not be eligible to take an active part in the management of the firm. Thus, a minor can share only the profits and can not be asked to bear the losses. However, he can if he wishes, inspect the accounts of the firm. The status of a minor changes when he attains majority. In fact, on attaining majority, the minor has to decide whether he would like to become a partner in the firm. He has to give a public notice of his decision within six months of attaining majority. If he fails to do so, within the stipulated time, he will be treated as a full-fledged partner and will become liable to the debts of the firm to an unlimited extent, in the same way as other active partners are.

is also a partner in Simplex Solutions. If credit is extended to Simplex Solutions on the basis of these negotiations, Rani would also be liable for repayment of such debt, as if she is a partner of the firm.

(vi) Partner by holding out: A partner by 'holding out' is a person who though is not a partner in a firm but knowingly allows himself/herself to be represented as a partner in a firm. Such a person becomes liable to outside creditors for repayment of any debts which have been extended to the firm on the basis of such representation. In case he is not really a partner and wants to save himself from such a liability, he should immediately issue a denial, clarifying his position that he is not a partner in the firm. If he does not do so, he will be responsible to the third party for any such debts.

2.4.2 Types of Partnerships

Partnerships can be classified on the basis of two factors, viz., duration and liability. On the basis of duration, there can be two types of partnerships : 'partnership at will' and 'particular partnership'. On the basis of liability, the two types of partnership include: one 'with limited liability' and the other one 'with unlimited liability'. These types are described in the following sections.

Classification on the basis of duration

(i) Partnership at will: This type of partnership exists at the will of the

partners. It can continue as long as the partners want and is terminated when any partner gives a notice of withdrawal from partnership to the firm.

(ii) Particular partnership: Partnership formed for the accomplishment of a particular project say construction of a building or an activity to be carried on for a specified time period is called particular partnership. It dissolves automatically when the purpose for which it was formed is fulfilled or when the time duration expires.

Classification on the basis of liability

(i) 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.

(ii) 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. Registration of such partnership is compulsory.

This form of partnership was not permitted in India earlier. The permission to form partnership firms with limited liability has been granted after introduction of New Small Enterprise Policy in 1991. The idea behind such a move has been to enable the partnership firms to attract equity capital from friends and relatives of small scale entrepreneurs who were earlier reluctant to help, due to the existence of unlimited liability clause in the partnership form of business.

2.4.3 Partnership Deed

A partnership is a voluntary association of people who come together for

Price Waterhouse Coopers was a Partnership Firm earlier

Price Waterhouse Coopers, one of the world's top accountancy firms has been created in 1998 by the merger of two companies, Price Waterhouse and Coopers and Lybrand — each with historical roots going back some 150 years to the 19th century Great Britain. In 1850, Samuel Lowell Price set up his accounting business in London. In 1865, he was joined in partnership by William H. Holyland and Edwin Waterhouse. As the firm grew, qualified members of its professional staff were admitted to the partnership. By the late 1800s, Price Waterhouse had gained significant recognition as an accounting firm.

Source: *Price Waterhouse Coopers archives in Columbia University.*

achieving common objectives. In order to enter into partnership, a clear agreement with respect to the terms, conditions and all aspects concerning the partners is essential so that there is no misunderstanding later among the partners. Such an agreement can be oral or written. Even though it is not essential to have a written agreement, it is advisable to have a written agreement as it constitutes an evidence of the conditions agreed upon. The written agreement which specifies the terms and conditions that govern the partnership is called the partnership deed.

The partnership deed generally includes the following aspects:

- Name of firm
- Nature of business and location of business
- Duration of business
- Investment made by each partner
- Distribution of profits and losses
- Duties and obligations of the partners
- Salaries and withdrawals of the partners
- Terms governing admission, retirement and expulsion of a partner
- Interest on capital and interest on drawings
- Procedure for dissolution of the firm
- Preparation of accounts and their auditing
- Method of solving disputes

2.4.4 Registration

Registration of a partnership firm means the entering of the firm's name, along with the relevant prescribed particulars, in the Register of firms kept with the Registrar of Firms. It provides conclusive proof of the existence of a partnership firm.

It is optional for a partnership firm to get registered. In case a firm does not get registered, it is deprived of many benefits. The consequences of non-registration of a firm are as follows:

(a) A partner of an unregistered firm cannot file a suit against the firm or other partners,
(b) The firm cannot file a suit against third parties, and
(c) The firm cannot file a case against the partners.

In view of these consequences, it is therefore advisable to get the firm registered. According to the Indian Partnership Act 1932, the partners may get the firm registered with the Registrar of firms of the state in which the firm is situated. The registration can be at the time of formation or at any time during its existence. The procedure for getting a firm registered is as follows:

1. Submission of application in the prescribed form to the Registrar of firms. The application should contain the following particulars:
   - Name of the firm
   - Location of the firm
   - Names of other places where the firm carries on business
   - The date when each partner joined the firm
   - Names and addresses of the partners
   - Duration of partnership

This application should be signed by all the partners.

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

E. H. Calvert

Cooperative organisation is "a society which has its objectives for the promotion of economic interests of its members in accordance with cooperative principles.

The Indian Cooperative Societies Act 1912

2. Deposit of required fees with the Registrar of Firms.
3. The Registrar after approval will make an entry in the register of firms and will subsequently issue a certificate of registration.

2.5 Cooperative Society

The word cooperative means working together and with others for a common purpose.

The cooperative society is a voluntary association of persons, who join together with the motive of welfare of the members. They are driven by the need to protect their economic interests in the face of possible exploitation at the hands of middlemen obsessed with the desire to earn greater profits.

The cooperative society is compulsorily required to be registered under the Cooperative Societies Act 1912. The process of setting up a cooperative society is simple enough and at the most what is required is the consent of at least ten adult persons to form a society. The capital of a society is raised from its members through issue of shares. The society acquires a distinct legal identity after its registration.

Features

The characteristics of a cooperative society are listed below.

(i) Voluntary membership: The membership of a cooperative society is voluntary. A person is free to join a cooperative society, and can also leave anytime as per his desire. There cannot be any compulsion for him to join or quit a society. Although procedurally a member is required to serve a notice before leaving the society, there is no compulsion to remain a member. Membership is open to all, irrespective of their religion, caste, and gender.

(ii) Legal status: Registration of a cooperative society is compulsory. This accords a separate identity to the society which is distinct from its members. The society can enter into contracts and hold property in its name, sue and be sued by others. As a result of being a separate legal entity, it is not affected by the entry or exit of its members.

(iii) Limited liability: The liability of the members of a cooperative society is limited to the extent of the amount contributed by them as capital. This defines the maximum risk that a member can be asked to bear.

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

(v) Service motive: The cooperative society through its purpose lays emphasis on the values of mutual help and welfare. Hence, the motive of service dominates its working. If any surplus is generated as a result of its operations, it is distributed amongst the members as dividend in conformity with the bye-laws of the society.

Merits

The cooperative society offers many benefits to its members. Some of the advantages of the cooperative form of organisation are as follows.

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

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

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

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

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

(vi) Ease of formation: The cooperative society can be started with a minimum of ten members. The registration procedure is simple involving a few legal formalities. Its formation is governed by the provisions of Cooperative Societies Act 1912.

Limitations

The cooperative form of organisation suffers from the following limitations:

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

(ii) 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 secrecy: As a result of open discussions in the meetings of members as well as disclosure obligations as per the Societies Act (7), it is difficult to maintain secrecy about the operations of a cooperative society.

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

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

2.5.1 Types of Cooperative Societies

Various types of cooperative societies based on the nature of their operations are described below:

(i) Consumer's cooperative societies: The consumer cooperative societies are formed to protect the interests of consumers. The members comprise of consumers desirous of obtaining good quality products at reasonable prices. The society aims at eliminating

Amul's amazing Cooperative ventures!

Every day Amul collects 4,47,000 litres of milk from 2.12 million farmers (many illiterate), converts the milk into branded, packaged products, and delivers goods worth Rs. 6 crore (Rs. 60 million) to over 5,00,000 retail outlets across the country.

It all started in December 1946 with a group of farmers keen to free themselves from intermediaries, gain access to markets and thereby ensure maximum returns for their efforts. Based in the village of Anand, the Khera District Milk Cooperative Union (better known as Amul) expanded exponentially. It joined hands with other milk cooperatives, and the Gujarat network now covers 2.12 million farmers, 10,411 village level milk collection centres and fourteen district level plants (unions). Amul is the common brand for most product categories produced by various unions: liquid milk, milk powder, butter, *ghee*, cheese, cocoa products, sweets, ice-cream and condensed milk. Amul's sub-brands include variants such as Amulspray, Amulspree, Amulya and Nutramul.

Source: *Adapted from Pankaj Chandra, "Rediff.com", Business Special, September 2005.*

middlemen to achieve economy in operations. It purchases goods in bulk directly from the wholesalers and sells goods to the members, thereby eliminating the middlemen. Profits, if any, are distributed on the basis of either their capital contributions to the society or purchases made by individual members.

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

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

Table 2.2 Indian Companies in League of FORTUNE GLOBAL 500 Organisations

Company	GLOBAL 500 rank	Rank in India	Revenues (Million $)	Profits (Million $)	Website
Indian Oil	170	1	29,643.2	1,218.8	www.iocl.com
Reliance Industries	417	2	14,841.0	1,699.9	www.ril.com
Bharat Petroleum	429	3	14,436.9	343.4	www.bharatpetroleum.com
Hindustan Petroleum	436	4	14,114.9	315.5	www.hindustanpetroleum.com
Oil and Natural Gas Commission (ONGC)	454	5	13,751.7	319.5	www.ongcindia.com
Total			86,787.7	3,897.1	

Source: *Adapted from The Fortune Global 500, July 25, 2005.*

transportation, warehousing, packaging, etc., to sell the output at the best possible price. Profits are distributed according to each member's contribution to the pool of output.

(iv) Farmer's cooperative societies: These societies are established to protect the interests of farmers by providing better inputs at a reasonable cost. The members comprise of farmers who wish to jointly take up farming activities. The aim is to gain the benefits of large scale farming and increase the productivity. Such societies provide better quality seeds, fertilisers, machinery and other modern techniques for use in the cultivation of crops. This helps not only in improving the yield and returns to the farmers, but also solves the problems associated with the farming on fragmented land holdings.

(v) Credit cooperative societies: Credit cooperative societies are established for providing easy credit on reasonable terms to the members. The members comprise of persons who seek financial help in the form of loans. The aim of such societies is to protect the members from the exploitation of lenders who charge high rates of interest on loans. Such societies provide loans to members out of the amounts collected as capital and deposits from the members and charge low rates of interest.

(vi) Cooperative housing societies: Cooperative housing societies are established to help people with limited income to construct houses at reasonable costs. The members of these societies consist of people who are desirous of procuring residential accommodation at lower costs. The aim is to solve the housing problems of the members by constructing houses and giving the option of paying in instalments. These societies construct flats or provide plots to members on which the members themselves can construct the houses as per their choice.

2.6 Joint Stock Company

A company is an association of persons formed for carrying out business activities and has a legal status independent of its members. A company can be described as an artificial person having a separate legal entity, perpetual succession and a common seal. The company form of organisation is governed by The Companies Act, 2013. As per section 2(20) of Act 2013, a company means company incorporated under this Act or any other previous company law.

The shareholders are the owners of the company while the Board of Directors is the chief managing body elected by the shareholders. Usually, the owners exercise an indirect control over the business. The capital of the company is divided into smaller parts

> Joint stock company is a voluntary association of individuals for profit, having a capital divided into transferable shares, the ownership of which is the condition of membership. *Prof. Haney*

called 'shares' which can be transferred freely from one shareholder to another person (except in a private company).

Features

The definition of a joint stock company highlights the following features of a company.

requirements before it can start functioning. Incorporation of companies is compulsory under The Companies Act 2013 or any of the previous company law, as state earlier. Such companies which are incorporated under companies Act 1956 or any company law shall be included in the list of companies.

Previous Company law means any of the laws specified below:
1. Act relating to companies in force before the Indian companies Act, 1866 (10 of 1866).
2. The Indian companies Act, 1866 (10 of 1866).
3. The Indian companies Act, 1882 (6 of 1882).
4. The Indian companies Act, 1913 (6 of 1913).
5. The Registration of Transferred Companies Ordinance, 1942 (ordinance 42 of 1942).
6. The Companies Act, 1956.

(i) Artificial person: A company is a creation of law and exists independent of its members. Like natural persons, a company can own property, incur debts, borrow money, enter into contracts, sue and be sued but unlike them it cannot breathe, eat, run, talk and so on. It is, therefore, called an artificial person.

(ii) Separate legal entity: From the day of its incorporation, a company acquires an identity, distinct from its members. Its assets and liabilities are separate from those of its owners. The law does not recognise the business and owners to be one and the same.

(iii) Formation: The formation of a company is a time consuming, expensive and complicated process. It involves the preparation of several documents and compliance with several legal

(iv) Perpetual succession: A company being a creation of the law, can be brought to an end only by law. It will only cease to exist when a specific procedure for its closure, called winding up, is completed. Members may come and members may go, but the company continues to exist.

(v) Control: The management and control of the affairs of the company is undertaken by the Board of Directors, which appoints the top management officials for running the business. The directors hold a position of immense significance as they are directly accountable to the shareholders for the working of the company. The shareholders, however, do not have the right to be involved in the day-to-day running of the business.

(vi) Liability: The liability of the members is limited to the extent of the capital contributed by them in a company. The creditors can use only the assets of the company to settle their claims since it is the company and not the members that owes the debt. The members can be asked to contribute to the loss only to the extent of the unpaid amount of share held by them. Suppose Akshay is a shareholder in a company holding 2,000 shares of Rs.10 each on which he has already paid Rs. 7 per share. His liability in the event of losses or company's failure to pay debts can be only up to Rs. 6,000 — the unpaid amount of his share capital (Rs. 3 per share on 2,000 shares held in the company). Beyond this, he is not liable to pay anything towards the debts or losses of the company.

(vii) Common seal: A company may or may not have a common seal. If a company has a common seal, it must be affixed to the documents such as agreements of a company. If a company does not have a common seal then the person signing the document should be authorised by a board's resolutions.

(viii) Risk bearing: The risk of losses in a company is borne by all the share holders. This is unlike the case of sole proprietorship or partnership firm where one or few persons respectively bear the losses. In the face of financial difficulties, all shareholders in a company have to contribute to the debts to the extent of their shares in the company's capital. The risk of loss thus gets spread over a large number of shareholders.

Merits

The company form of organisation offers a multitude of advantages, some of which are discussed below.

(i) Limited liability: The shareholders are liable to the extent of the amount unpaid on the shares held by them. Also, only the assets of the company can be used to settle the debts, leaving the owner's personal property free from any charge. This reduces the degree of risk borne by an investor.

(ii) Transfer of interest: The ease of transfer of ownership adds to the advantage of investing in a company as the share of a public limited company can be sold in the market and as such can be easily converted into cash in case the need arises. This avoids blockage of investment and presents the company as a favourable avenue for investment purposes.

(iii) Perpetual existence: Existence of a company is not affected by the death, retirement, resignation, insolvency or insanity of its members as it has a separate entity from its members. A company will continue to exist even if all the members die. It can be liquidated only as per the provisions of the Companies Act, 2013.

(iv) Scope for expansion: As compared to the sole proprietorship and partnership forms of organisation, a company has large

financial resources. Further, capital can be attracted from the public as well as through loans from banks and financial institutions. Thus there is greater scope for expansion. The investors are inclined to invest in shares because of the limited liability, transferable ownership and possibility of high returns in a company.

(v) Professional management: A company can afford to pay higher salaries to specialists and professionals. It can, therefore, employ people who are experts in their area of specialisations. The scale of operations in a company leads to division of work. Each department deals with a particular activity and is headed by an expert. This leads to balanced decision making as well as greater efficiency in the company's operations.

Limitations

The major limitations of a company form of organisation are as follows:

Pen is mightier than the Sword:
The Case of Luxor Writing Instruments Pvt. Ltd.

In the year 1963, a young gentleman armed with the power of hard work and ambition, started a new era in the field of writing instruments. At a tender age of 19, he started a small manual assembly shop in Sadar Bazaar area in Delhi where he manufactured fountain pens under the name **Luxor Writing Instruments Pvt. Ltd. (LWIPL).**

Being awarded the coveted ***'Number One Writing Instruments Exporter' award*** consecutively for three years, LWIPL has been given the exclusive rights of manufacturing and distributing four international brands in India, viz., **Pilot, Papermate, Parker and Waterman.**

Luxor Writing Instruments Pvt. Ltd. has the largest share of this market of over 20 percent, with a turnover pushing way beyond the Rs. 150 crore mark. As of today Luxor is a leading **manufacturer and exporter of writing instruments from India. It is currently exporting** over 15 percent of the output and has four manufacturing facilities in New Delhi and three at Mumbai. It employs over 600 people. It is the leader in most segments of the market, manufacturing and distributing a wide variety of pens for various applications and needs.

Source: *http://www.luxorparker.com*

(i) Complexity in formation: The formation of a company requires greater time, effort and extensive knowledge of legal requirements and the procedures involved. As compared to sole proprietorship and partnership form of organisations, formation of a company is more complex.

(ii) Lack of secrecy: The Companies Act requires each public company to provide from time-to-time a lot of

information to the office of the registrar of companies. Such information is available to the general public also. It is, therefore, difficult to maintain complete secrecy about the operations of company.

(iii) Impersonal work environment: Separation of ownership and management leads to situations in which there is lack of effort as well as personal involvement on the part of the officers of a company. The large size of a company further makes it difficult for the owners and top management to maintain personal contact with the employees, customers and creditors.

(iv) Numerous regulations: The functioning of a company is subject to many legal provisions and compulsions. A company is burdened with numerous restrictions in respect of aspects including audit, voting, filing of reports and preparation of documents, and is required to obtain various certificates from different agencies, viz., registrar, SEBI, etc. This reduces the freedom of operations of a company and takes away a lot of time, effort and money.

(v) Delay in decision making: Companies are democratically managed through the Board of Directors which is followed by the top management, middle management and lower level management. Communication as well as approval of various proposals may cause delays not only in taking decisions but also in acting upon them.

(vi) Oligarchic management: In theory, a company is a democratic institution wherein the Board of Directors are representatives of the shareholders who are the owners. In practice, however, in most large sized organisations having a multitude of shareholders; the owners have minimal influence in terms of controlling or running the business.

Table 2.3 Difference between a Public Company and Private Company

Basis	Public company	Private company
Members	Minimum - 7 Maximum - unlimited	Minimum - 2 Maximum - 200
Minimum number of directors	Three	Two
Index of members	Compulsory	Not compulsory
Transfer of shares	No restriction	Restriction on transfer
Invitation to public to subscribe to shares	Can invite the public to subscribe to its shares or debentures	Cannot invite the public to subscribe to its securities

It is so because the shareholders are spread all over the country and a very small percentage attend the general meetings. The Board of Directors as such enjoy considerable freedom in exercising their power which they sometimes use even contrary to the interests of the shareholders. Dissatisfied shareholders in such a situation have no option but to sell

Bharat Heavy Electricals Limited — A Public Company's Journey in Quality

Bharat Heavy Electricals Limited (BHEL) is the largest engineering and manufacturing enterprise in India today in the energy-related/infrastructure sector.

BHEL was established more than 40 years ago, ushering in the indigenous heavy electrical equipment industry in India — a dream that has been more than realised with a well-recognised track record of performance. The company has been earning profits continuously since 1971-72 and paying dividends since 1976-77.

BHEL manufactures over 180 products under 30 major product groups and caters to core sectors of the Indian economy, viz., power generation and transmission, transportation, telecommunication, renewable energy, etc.

BHEL has acquired certifications to Quality Management Systems (ISO 9001), Environmental Management Systems (ISO 14001) and Occupational Health and Safety Management Systems (OHSAS 18001) and is also well on its journey towards Total Quality Management.

Major achievements of BHEL include:

- Installed equipment for over 90,000 MW of power generation — for utilities, captive and industrial users.
- Supplied over 2,25,000 MVA transformer capacity and other equipment operating in transmission and distribution network up to 400 kV (AC and DC).
- Supplied over 25,000 motors with Drive Control System to power projects, petrochemicals, refineries, steel, aluminium, fertiliser, cement plants, etc.
- Supplied traction electrics and AC/DC locos to power over 12,000 kms railway network.
- Supplied over one million valves to power plants and other industries.

BHEL's vision is to become a world-class engineering enterprise, committed to enhancing stakeholder value. The company is striving to give shape to its aspirations and fulfil the expectations of the country to become a global player.

The greatest strength of BHEL is its highly skilled and committed 43,500 employees. Every employee is given an equal opportunity to develop himself and grow in his career. Continuous training and retraining, career planning, a positive work culture and participative style of management — all these have engendered development of a committed and motivated workforce setting new benchmarks in terms of productivity, quality and responsiveness.

Source: *website of BHEL*

their shares and exit the company. As the directors virtually enjoy the rights to take all major decisions, it leads to rule by a few.

(vii) Conflict in interests: There may be conflict of interest amongst various stakeholders of a company. The employees, for example, may be interested in higher salaries, consumers desire higher quality products at lower prices, and the shareholders want higher returns in the form of dividends and increase in the intrinsic value of their shares. These demands pose problems in managing the company as it often becomes difficult to satisfy such diverse interests.

2.6.1 Types of Companies

A company can be either a private or a public company. These two types of companies are discussed in detail in the following paragraphs.

Private Company

A private company means a company which:

(a) restricts the right of members to transfer its shares;
(b) has a minimum of 2 and a maximum of 200 members, excluding the present and past employees;
(c) does not invite public to subscribe to its securities and

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.

The following are some of the *privileges* of a private limited company as against a public limited company:

1. A private company can be formed by only two members whereas seven people are needed to form a public company.
2. There is no need to issue a prospectus as public is not invited to subscribe to the shares of a private company.
3. Allotment of shares can be done without receiving the minimum subscription. A private limited company can start business as soon as it receives the certificate of incorporation.
4. A private company needs to have only two directors as against the minimum of three directors in the case of a public company. However the maximum number of directors for both types of companies is fifteen.
5. A private company is not required to keep an index of members while the same is necessary in the case of a public company.

Public Company

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

(a) has a minimum of 7 members and no limit on maximum members;
(b) has no restriction on transfer securities; and

Table 2.4 Factors influencing the choice of form of Business Organisation

Form of organisation		
Factor	**Most advantageous**	**Least advantageous**
Availability of capital	Company	Sole proprietorship
Cost of formation	Sole proprietorship	Company
Ease of formation	Sole proprietorship	Company
Transfer of ownership	Company (except private company)	Partnership
Managerial skills	Company	Sole proprietorship
Regulations	Sole proprietorship	Company
Flexibility	Sole proprietorship	Company
Continuity	Company	Sole proprietorship
Liability	Company	Sole proprietorship

(c) is not prohibited from inviting the public to subscribe to its securities.

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

2.7 Choice of form of Business Organisation

After studying various forms of business organisations, it is evident that each form has certain advantages as well as disadvantages. It, therefore, becomes vital that certain basic considerations are kept in mind while choosing an appropriate form of organisation. The important factors determining the choice of organisation are listed in Table 2.4 and are discussed below:

(i) Cost and ease in setting up the organisation: As far as initial business setting-up costs are concerned, sole proprietorship is the most inexpensive way of starting a business. However, the legal requirements are minimum and the scale of operations is small. In case of partnership also, the advantage of less legal formalities and lower cost is there because of limited scale of operations. Cooperative societies and companies have to be compulsorily registered. Formation of a company involves a lengthy and expensive legal procedure. From the point of view of initial cost, therefore, sole proprietorship is the preferred form as it involves least expenditure. Company form of organisation, on the other hand, is more complex and involves greater costs.

(ii) Liability: In case of sole proprietorship and partnership firms, the liability of the owners/partners is unlimited. This may call for paying the debt from personal assets of the owners.

Table 2.5 Comparative Evaluation of Forms of Organisation

Basis of comparison	Sole proprietorship	Partnership	Joint Hindu family business	Cooperative society	Company
Formation	Minimal legal formalities, easiest formation	Registration is optional, easy formation	Less legal formalities, exemption from registration, easy formation	Registration compulsory, greater legal formalities	Registration compulsory, lengthy and expensive formation process
Members	Only owner	Minimum-2 Maximum: 50	At least two persons for division of family property, no maximum limit	At least 10 adults, no maximum limit	Minimum Private-2 Public Company-7 Maximum Private Company-200 Public Company-unlimited
Capital contribution	Limited finance	Limited but more than that can be raised in case of sole proprietorship	Ancestral property	Limited	Large financial resources
Liability	Unlimited	Unlimited and joint	Unlimited *(Karta)*, Limited (Other members)	Limited	Limited
Control and management	Owner takes all decisions, quick decision making	Partners take decisions, consent of all partners is needed	Karta takes decisions	Elected representative, i.e., managing committee takes decisions	Separation between ownership and management
Continuity	Unstable, business and owner regarded as one	More stable but affected by status of partners	Stable business, continues even if *karta* dies	Stable because of separate legal status	Stable because of separate legal status

In joint Hindu family business, only the *karta* has unlimited liability. In cooperative societies and companies, however, liability is limited and creditors can force payment of their claims only to the extent of the company's assets. Hence, from the point of view of investors, the company form of organisation is more suitable as the risk involved is limited.

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

(iv) Management ability: A sole proprietor may find it difficult to have expertise in all functional areas of management. In other forms of organisations like partnership and company, there is no such problem. Division of work among the members in such organisations allows the managers to specialise in specific areas, leading to better decision making. But this may lead to situations of conflicts because of differences of opinion amongst people. Further, if the organisation's operations are complex in nature and require professionalised management, company form of organisation is a better alternative. Proprietorship or partnership may be suitable, where simplicity of operations allow even people with limited skills to run the business. Thus, the nature of operations and the need for professionalised management affect the choice of the form of organisation.

(v) Capital considerations: Companies are in a better position to collect large amounts of capital by issuing shares to a large number of investors. Partnership firms also have the advantage of combined resources of all partners. But the resources of a sole proprietor are limited. Thus, if the scale of operations is large, company form may be suitable whereas for medium and small sized business one can opt for partnership or sole proprietorship. Further, from the point of view of expansion, a company is more suitable because of its capability to raise more funds and invest in expansion plans. It is precisely for this purpose that in our opening case Neha's father suggested she should consider switching over to the company form of organisation.

(vi) Degree of control: If direct control over operations and absolute decision making power is required, proprietorship may be preferred. But if the owners do not mind sharing control and decision making, partnership or company form of

organisation can be adopted. The added advantage in the case of company form of organisation is that there is complete separation of ownership and management and it is professionals who are appointed to independently manage the affairs of a company.

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

It would not be out of place to mention here that the factors stated above are inter-related. Factors like capital contribution and risk vary with the size and nature of business, and hence a form of business organisation that is suitable from the point of view of the risks for a given business when run on a small scale might not be appropriate when the same business is carried on a large scale. It is, therefore, suggested that all the relevant factors must be taken into consideration while making a decision with respect to the form of organisation that should be adopted.

Key Terms

Sole proprietorship	Partnership	Joint Hindu Family
Mutual agency	Cooperative Societies	Joint Stock Company
Perpetual succession	Artificial person	Holding company
Co-parceners	Incorporation of a Company	

SUMMARY

Forms of business organisation refers to the types of organisations which differ in terms of ownership and management. The major forms of organisation include proprietorship, partnership, joint Hindu family business, cooperative society and company.

Sole proprietorship refers to a form of organisation where business is owned, managed and controlled by a single individual who bears all the risks and is the only recipient of all the profits. Merits of this form of organisation include quick decision making, direct incentive, personal satisfaction, and ease of formation and closure. But this form of organisation suffers from limitations of limited resources, unstable life

span of business, unlimited liability of sole proprietor and his/her limited managerial ability.

Partnership is defined as an association of two or more persons who agree to carry on a business together and share the profits as well as bear risks collectively. Major advantages of partnership are: ease of formation and closure, benefits of specialisation, greater funds, and reduction of risk. Major limitations of partnership are unlimited liability, possibility of conflicts, lack of continuity and lack of public confidence. As there are different types of partners such as active, sleeping, secret and nominal partners; so is the case with types of partnerships which can vary from general partnership, limited partnership, partnership at will to particular partnership.

Joint Hindu family business is a business owned and carried on by the members of a Hindu Undivided Family, which is governed by the Hindu law. *Karta* — the oldest male member of the family — controls the business. The strong points of joint Hindu family business include effective control, stability in existence, limited liability and increased loyalty among family members. But this form of organisation too suffers from certain limitations such as limited resources, lack of incentives, dominance of the *karta* and limited managerial ability.

A cooperative society is a voluntary association of persons who get together to protect their economic interests. The major advantages of a cooperative society are equality in voting, members' limited liability, stable existence, economy in operations, support from government, and ease of formation. But this form of organisation suffers from weaknesses such as limited resources, inefficiency in management, lack of secrecy, government control, and differences among members in regard to the way society should be managed and organised. Based on their purpose and nature of members, various types of societies that can be formed include: consumers cooperative society, producers cooperative society, marketing cooperative society, farmers cooperative society, credit cooperative society, and cooperative housing society.

A company, on the other hand, may be defined as an artificial person, existing only in the eyes of the law with perpetual succession and having a separate legal identity. While major advantages of a company form of organisation are members' limited liability, transfer of interest, stable existence, scope for expansion, and professional management; its key limitations are: complexity in formation, lack of secrecy, impersonal work environment, numerous regulations, delay in decision making, oligarchic management, and conflict of interests among different shareholders.

Companies can be of two types — private and public. A private company is one which restricts transfer of shares and does not invite the public to

subscribe to its securities. A public company, on the other hand, is allowed to raise its funds by inviting the public to subscribe to its securities. Furthermore, there is a free transferability of securities in the case of a public company.

Choice of form of organisation: Selection of an appropriate form of organisation can be made after taking various factors into consideration. Initial costs, liability, continuity, capital considerations, managerial ability, degree of control and nature of business are the key factors that need to taken into account while deciding about the suitable form of organisation for one's business.

EXERCISES

Multiple Choice Questions

Tick the appropriate answer

1. The structure in which there is separation of ownership and management is called
   (a) Sole proprietorship (b) Partnership
   (c) Company (d) All business organisations

2. The *karta* in Joint Hindu family business has
   (a) Limited liability (b) Unlimited liability
   (c) No liability for debts (d) Joint liability

3. In a cooperative society the principle followed is
   (a) One share one vote (b) One man one vote
   (c) No vote (d) Multiple votes

4. The board of directors of a joint stock company is elected by
   (a) General public (b) Government bodies
   (c) Shareholders (d) Employees

5. Profits do not have to be shared. This statement refers to
   (a) Partnership (b) Joint Hindu family business
   (c) Sole proprietorship (d) Company

6. The capital of a company is divided into number of parts each one of which are called
   (a) Dividend (b) Profit
   (c) Interest (d) Share

7. The Head of the joint Hindu family business is called
   (a) Proprietor (b) Director
   (c) *Karta* (d) Manager

8. Provision of residential accommodation to the members at reasonable rates is the objective of
   (a) Producer's cooperative (b) Consumer's cooperative
   (c) Housing cooperative (d) Credit cooperative

9. A partner whose association with the firm is unknown to the general public is called
   (a) Active partner (b) Sleeping partner
   (c) Nominal partner (d) Secret partner

Short Answer Questions

1. Compare the status of a minor in a joint hindu family business with that in a partnership firm.
2. If registration is optional, why do partnership firms willingly go through this legal formality and get themselves registered? Explain.
3. State the important privileges available to a private company.
4. How does a cooperative society exemplify democracy and secularism? Explain.
5. What is meant by 'partner by estoppel'? Explain.
6. Briefly explain the following terms in brief.
   (a) Perpetual succession (b) Common seal
   (c) *Karta* (d) Artificial person

Long Answer Questions

1. What do you understand by a sole proprietorship firm? Explain its merits and limitation?
2. Why is partnership considered by some to be a relatively unpopular form of business ownership? Explain the merits and limitations of partnership.
3. Why is it important to choose an appropriate form of organisation? Discuss the factors that determine the choice of form of organisation.
4. Discuss the characteristics, merits and limitation of cooperative form of organisation. Also describe briefly different types of cooperative societies.

5. Distinguish between a Joint Hindu family business and partnership.
6. Despite limitations of size and resources, many people continue to prefer sole proprietorship over other forms of organisation? Why?

Application Questions

1. In which form of organisation is a trade agreement made by one owner binding on the others? Give reasons to support your answer.
2. The business assets of an organisation amount to Rs. 50,000 but the debts that remain unpaid are Rs. 80,000. What course of action can the creditors take if
   (a) The organisation is a sole proprietorship firm
   (b) The organisation is a partnership firm with Anthony and Akbar as partners. Which of the two partners can the creditors approach for repayment of debt? Explain giving reasons
3. Kiran is a sole proprietor. Over the past decade, her business has grown from operating a neighbourhood corner shop selling accessories such as artificial jewellery, bags, hair clips and nail art to a retail chain with three branches in the city. Although she looks after the varied functions in all the branches, she is wondering whether she should form a company to better manage the business. She also has plans to open branches countrywide.
   (a) Explain two benefits of remaining a sole proprietor
   (b) Explain two benefits of converting to a joint stock company
   (c) What role will her decision to go nationwide play in her choice of form of the organisation?
   (d) What legal formalities will she have to undergo to operate business as a company?

Projects/Assignments

Divide students into teams to work on the following
   (a) To study the profiles of any five neighbourhood grocery/stationery store
   (b) To conduct a study into the functioning of a Joint Hindu family businesses
   (c) To enquire into the profile of five partnerships firms
   (d) To study the ideology and working of cooperative societies in the area

(e) To study the profiles of any five companies (inclusive of both private and public companies)

Notes

1. Some of the following aspects can be assigned to the students for undertaking above mentioned studies.

   Nature of business, size of the business measured in terms of capital employed, number of persons working, or sales turnover, problems faced, Incentive, reason behind choice of a particular form, decision making pattern, willingness to expand and relevant considerations, Usefulness of a form, etc.

2. Students teams should be encouraged to submit their findings and conclusions in the form of project reports and multi-media presentations.