

CHAPTER - 2

FORMS OF BUSINESS ORGANISATION

- **Introduction:**

Decision relating to the form of organization plays an important role if one has to start a business. The forms of organization are (i) Sole proprietorship (ii) Partnership (iii) Joint Hindu Family business. (iv) Co-operative society (v) Joint Stock Company.

- **Important Concept**

- **Meaning of Sole Proprietorship:** It refers to a form of business organization which is owned, managed and controlled by an individual who is in receipt of all profits and bearer of all risks.

Features:

(i) Easy to form and close (ii) Liability (iii) Only bearer of profit and loss (iv) Control (v) No separate entity. (vi) Lack of business continuity.

Merits:

(i) Quick decision making (ii) Personal satisfaction (iii) Information will be kept secretly (iv) Direct incentive (v) Ease of formation and closure.

Demerits:

(i) Limited resources (ii) Limited life of a business concern. (iii) Unlimited liability (iv) Limited managerial ability.

- **Meaning of Joint Hindu Family Business:** Karta eldest member of the family controls the business.

Features:

(i) Formation (ii) Liability (iii) Control (iv) Continuity (v) Minor members.

Merits:

(i) Effective control (ii) Continuity of business (iii) limited liability of members (iv) Increased loyalty.

Demerits:

(i) Limited resources (ii) unlimited liability of karta (iii) Karta's dominance (iv) limited managerial skills.

- **Meaning of Partnership:** Relation between persons to share the profits of the business carried on by all the partners or any one of the partner acting on behalf of all the other partners

Features:

(i) Formation (ii) Liability (iii) Risk bearing (iv) decision making (v) continuity (vi) Member

Merits:

(i) Easy to start and close (ii) proper decision making (iii) More money (iv) secrets are maintained.

Limitations:

(i) Unlimited liability (ii) Fights exist (iii) Chances for closure (iv) No public confidence.

Types

(i) Active (ii) sleeping (iii) secret (iv) Nominal (v) partner by behaviors (vi) partner by holding out.

Kinds of partnership:

(i) At Interest (ii) Formed for completing a work

Partnership deed: It contains the rules and regulations for carrying on partnership.

- **Meaning of Cooperative Society:** It is a voluntary association of persons formed for protecting the consumers from middlemen.

Features:

(i) Voluntary association (ii) service motive (iii) power to take decisions (iv) limited liability.(v) Registration is compulsory so they have legal status.

Merits:

(i) Equal voting rights. (ii) Continuous existence (iii) low cost of operation (iv) Government support (v) Easy to start (vi) limited liability.

Limitations:

(i) Resources are little (ii) Difference of opinion. (iii) Management is not proper (iv) Strict rules from the government.

Types:

(i) Consumer (ii) Producer (iii) Marketing (iv) Farmer's (v) Credit (vi) Cooperative housing societies.

- **Meaning Of Joint Stock Company:** Company is an artificial person with continuous existence& common seal.

Features:

(i) Artificial person (ii) Formation is difficult (iii) Company has separate identity. (iv) Continuous existence (v) Control of the company is made by directors. (vi) liability is limited. (vii) Common seal.

Merits:

(i) Liability is limited (ii) Chances are there for expansion (iii) Managed by professional people (iv) Continuous existence (v) Shares can be easily transferred from one person to another person.

Demerits:

(i) Very difficult to form (ii) No secrecy (iii) No personal involvement. (iv) More rules and regulations. (v) very slow in decision making (vi) owners have less control.

Types of Companies:

(i) Private company (ii) Public company.

Choice of form of Business organization: (i) less costly in setting up the organization

(ii) Limited liability (iii) continuous existence (iv) Form of raising capital (v) Control to be made (vi) Nature of business.

- **Formation of a Company**

STAGES

Promotion: Functions of a Promoter:

(i) Finding out a business opportunity (ii) Conducting studies (iii) Getting the name approved. (iv) Fixing up persons to sign Memorandum of association (v) Appointment of professionals. (vii) preparation of necessary documents.

Documents: Memorandum of association:

(i) Name clause (ii) Registered office clause (iii) Objects clause (iv) Liability clause (v) Capital clause (vi) Association clause. (vii) Articles of association. (viii) Consent of directors (ix) Agreement with managing director or whole time director (x) Statutory declaration

Incorporation: The memorandum of association must be duly stamped, signed and witnessed. (ii) The articles of association duly stamped and witnessed. (iii) Written permission of the directors. (iv) Agreement with the managing director/manager. (v) A copy of the registrar's letter giving permission for the name. (vi) A declaration that all the legal requirements are followed. (vii) A notice about the exact office of the registered office. (viii) Documents showing the payment of fees.

Capital subscription:

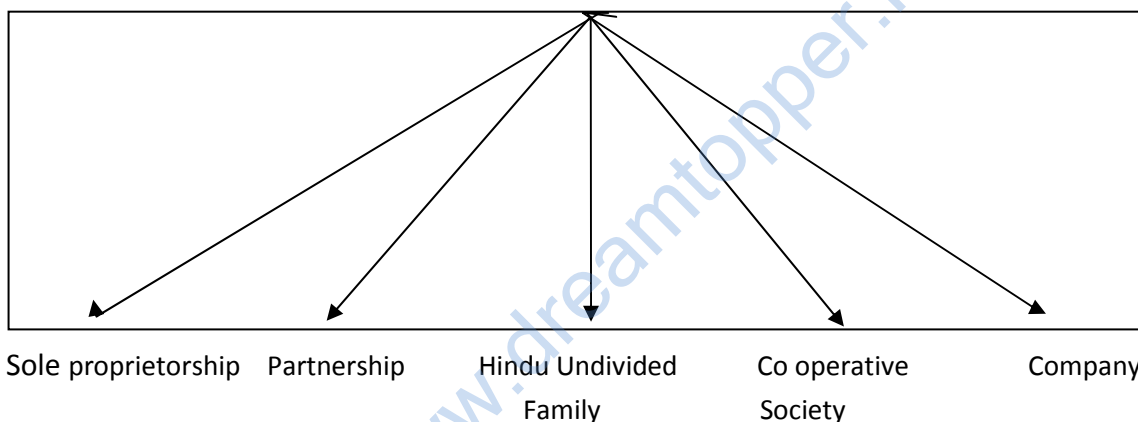
(i) SEBI approval (ii) Filing of prospectus. (iii) Appointment of brokers, bankers etc., (iv) Collection of minimum subscription (v) Application to stock exchange (vi) Allotment of shares.

- **Commencement of Business:**

(i) A declaration about meeting minimum subscription requirement. (ii) A declaration regarding the application and allotment money paid by the directors as same as others. (iii) A declaration that no money is payable to the applicants because of the failure of the company. (iv) A statutory declaration that the above particulars are followed. (v) The registrar shall examine the documents if these are found satisfactory a certificate of commencement of business will be issued.

- **Key Concepts in Nutshell:**

FORMS OF BUSINESS ORGANISATION



- **Meaning Of Sole Proprietorship:**

Sole means only

Proprietor means owner

Merits of sole proprietorship:

1. A sole proprietor can take decision quickly.
2. Information can be kept secretly without any leakage.
3. No need to share profits.
4. He gets self satisfaction for the work he has done.
5. Easy to start and to close because of less rules and regulations.

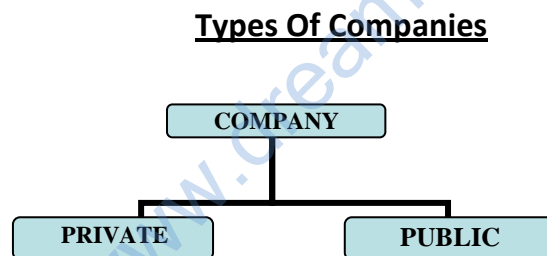
- **Partnership**

Types of Partners :

1. **Active partner:** An active partner is a partner who gives capital, participates in management, shares the profits and losses and has unlimited liability.
2. **Sleeping partner:** A Partner who do not take part in the business activities.
3. **Secret partner:** A partner who has association with the firm but unknown to the public.
4. **Nominal partner:** A partner who allows his name to be used by the firm
5. **Partner by estoppel:** A person who by behaviour sets an impression to others that he/she is a partner of the firm.
6. **Partner by holding out:** A person who is not a partner but allows himself to be represented as partner in a firm.

Consequences of Non Registration:

1. A Partner of an unregistered firm cannot file a case against the firm or other partners.
2. The firm cannot file a case against third parties.
3. The firm cannot file a case against the partners.



- **Public Company:**

1. Members: Minimum 7, Maximum unlimited
2. Minimum number of directors: 3
3. Minimum paid up capital: 5 lakhs.
4. Index of members: Compulsory.
5. Transfer of shares: Shares can be transferred easily from one person to another.
6. Invitation to public: It can invite the public to purchase the share and debentures

- **Private Company:**

1. Members: Minimum 2, Maximum -50.
2. Minimum number of directors: 2
3. Minimum paid up capital: 1 lakh
4. Index of members: Not compulsory.

5. Transfer of shares: Shares cannot be transferred from one person to another.
6. Invitation to public: It cannot invite the public to purchase the share and debentures.

- **Memorandum of Association:**

1. It defines the objects for which the company is formed.
2. This is the main document of the company.
3. This defines the relationship of the company with outsiders.
4. Every company has to file Memorandum of Association.
5. Alteration of Memorandum of Association is difficult.

- **Articles of Association:**

1. It defines the objectives of the company that are to be achieved.
2. This is the subsidiary document of the company.
3. Articles define the relationship of the members and the company.
4. It is not necessary for the public limited company.
5. It can be altered by passing a special resolution.

- **Very Short Answer type Questions:**

(1 Mark)

1. Varun is the only owner of his restaurant. Name the form of business organization. **Ans:** Sole proprietorship.
2. Name the form of organization found only in India **Ans:** JHF
3. List two merits of Sole proprietorship.
Ans: (i) Single ownership (ii) Full control.
4. Name any one business in which sole proprietorship is most suitable.
Ans: Tailoring
5. Name the type of partnership which is formed to accomplish a specific project for a specific time.
Ans: Particular partnership
6. State any one consequence of non registration of a partnership firm.
Ans: An unregistered firm cannot file a case against third parties.
7. What is the minimum number of persons required to form a cooperative society?
Ans: Ten
8. Name the type of company which can invite the public to subscribe for the shares or debentures. **Ans:** Public.
9. Name the process by which a joint stock company is registered.
Ans: Incorporation.
10. Name the document which defines the object and powers of the company.
Ans: Memorandum of Association.

• **Short Answer Type Questions:** **(3 or 4 Marks)**

1. State three advantages of joint Hindu Family business.

Ans (i) Effective control (ii) Continuity of business (iii) limited liability of members (iv) Increased loyalty. (any three)

2. Explain the features of a Joint Hindu Family business.

Ans: (i) Formation (ii) Liability (iii) Control

3. List any three advantages of partnership.

Ans: (i) Easy to start and close (ii) proper decision making (iii) More money (iv) secrets are maintained.

4. State the important features of partnership.

Ans: (i) Formation (ii) Liability (iii) Risk bearing (iv) decision making (v) continuity (vi) Member .

5. What are the consequences of nonregistration of a partnership firm?

Ans: A Partner of an unregistered firm cannot file a case against the firm or other partners.

The firm cannot file a case against third parties.

The firm cannot file a case against the partners.

6. Explain any three features of a company.

(i) Artificial person (ii) Formation is difficult (iii) Company has separate Identity.

7. Enumerate the various types of cooperative societies.

(i) Consumer (ii) Producer (iii) Marketing (iv) Farmer's (v) Credit (vi) Cooperative housing societies

8. What are the functions of a promoter?

(i) Finding out a business opportunity (ii) Conducting studies (iii) Getting the name approved. (iv) Fixing up persons to sign Memorandum of Association.

(v) Appointment of professionals. (vii) preparation of necessary Documents.

• **Long Answer Type Questions:** **(5 or 6 Marks)**

1. Distinguish between Memorandum of Association and Articles of Association.

Answer :

Memorandum of Association

1. It defines the objects for which the company is formed.
2. This is the main document of the company.
3. This defines the relationship of the company with outsiders.
4. Every company has to file Memorandum Of Association.
5. Alteration of Memorandum of Association is difficult.

Articles of Association

6. It defines the objectives of the company that are to be achieved.
 7. This is the subsidiary document of the company.
 8. Articles define the relationship of the members and the company.
 9. It is not necessary for the public limited company.
 10. It can be altered by passing a special resolution.
2. Distinguish between a private company and public company.

Answer :

PUBLIC COMPANY:

Members: Minimum 7, Maximum unlimited

Minimum number of directors: 3

Minimum paid up capital: 5 lakhs.

Index of members: Compulsory.

Transfer of shares: Shares can be transferred easily from one person to another.

Invitation to public: It can invite the public to purchase the share and debentures

PRIVATE COMPANY:

Members: Minimum 2, Maximum -50.

Minimum number of directors: 2

Minimum paid up capital: 1 lakh

Index of members: Not compulsory.

Transfer of shares: Shares cannot be transferred from one person to another.

Invitation to public: It cannot invite the public to purchase the share and debentures.

3. Describe the various partners in a partnership firm.

Answer :

TYPES OF PARTNERS

Active partner: An active partner is a partner who gives capital, participates in management, shares the profits and losses and has unlimited liability.

Sleeping partner: A Partner who do not take part in the business activities.

Secret partner: A partner who has association with the firm but unknown to the public.

Nominal partner: A partner who allows his name to be used by the firm

Partner by estoppel: A person who by behaviour sets an impression to others that he/she is a partner of the firm.

Partner by holding out: A person who is not a partner but allows himself to be represented as partner in a firm.

4. Why is company form of organization preferred than other forms of organization?

Answer :

Merits: (i) Liability is limited (ii) Chances are there for expansion
iii) Managed by professional people (iv) Continuous existence (v) Shares can be easily transferred from one person to another person.

5. List and explain the factors which help in choosing an appropriate form of Organization.

Answer :

Choice of form of Business organization: (i) less costly in setting up the Organization. (ii) Limited liability (iii) continuous existence (iv) Form of raising capital (v) Control to be made (vi) Nature of business.

HOTs

1. "One man control is the best in the world if that man is big enough to manage everything". Explain.

Answer :

Merits of sole proprietorship:

1. A sole proprietor can take decision quickly.
 2. Information can be kept secretly without any leakage.
 3. No need to share profits.
 4. He gets self satisfaction for the work he has done.
 5. Easy to start and to close because of less rules and regulations.
2. "A private company avoids many of the defects of a public company". Explain.

Answer :

Merits: (i) Liability is limited (ii) Chances are there for expansion
(iii) Managed by professional people (iv) Continuous existence (v) Shares can be easily transferred from one person to another person.

3. State the reasons for issuing prospectus:

Answer :

1. It serves as an invitation to the public to invest in the shares and debentures of the company.
2. It acts as an advertisement for inducing the investors to invest in the company.
3. It serves as an record of the terms and conditions on which shares and debentures are issued.
4. It helps to protect the interest of the investors.

4. "A company is said to be an artificial person created by law, having a separate entity with perpetual succession and a common seal". Discuss the above statement.

Answer :

Features: (i) Artificial person (ii) Formation is difficult (iii) Company has separate identity. (iv) Continuous existence (v) Control of the company is made by directors. (vi) liability is limited. (vii) Common seal.

5. Describe the steps involved in the floatation of the company.

Answer :

Capital subscription:

1. SEBI Approval.
2. Filing of prospectus.
3. Appointment of bankers, brokers and underwriters.
4. Minimum subscription.
5. Application of stock exchange.
6. Allotment of shares.

● **Gist of the Lesson:**

- ❖ *Sole proprietorship – one owner*
- ❖ *Partnership – 2 or more partners.*
- ❖ *Joint Hindu Family Business- at least 2 persons.*
- ❖ *Cooperative society – At least 10 adults.*
- ❖ *Company – Minimum 2 Maximum 50 (Private)*
- ❖ *Company- Minimum 7 Maximum-unlimited.*
- ❖ *Memorandum of Association- External rules and regulations.*
- ❖ *Articles of Association – Internal rules and regulations.*