

## Ch 2 Forms of Business Organisation

Page No: 51

### Exercises

#### Multiple Choice Questions

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

► (c) Company

2. The karta in Joint Hindu family business has

- (a) Limited liability
- (b) Unlimited liability
- (c) No liability for debts
- (d) Joint liability

► (b) Unlimited 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

► (b) One man one vote

4. The board of directors of a joint stock company is elected by

- (a) General public
- (b) Government bodies
- (c) Shareholders
- (d) Employees

► (c) Shareholders

5. The maximum number of partners allowed in the banking business are

- (a) Twenty
- (b) Ten
- (c) No limit
- (d) Two
- (b) Ten

6. Profits do not have to be shared. This statement refers to

- (a) Partnership
- (b) Joint Hindu family business
- (c) Sole proprietorship
- (d) Company
- (c) Sole proprietorship

Page No: 52

7. 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
- (d) Share

8. The Head of the joint Hindu family business is called

- (a) Proprietor
- (b) Director
- (c) Karta
- (d) Manager
- (c) Karta

9. Provision of residential accommodation to the members at reasonable rate is the objective of

- (a) Producer's cooperative
- (b) Consumer's cooperative
- (c) Housing cooperative
- (d) Credit cooperative
- (c) Housing cooperative

10. 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
- (d) Secret partner

### Short Answer Questions

1. For which of the following types of business do you think a sole proprietorship form of organisation would be more suitable, and why?

- (a) Grocery store
- (b) Medical store
- (c) Legal consultancy
- (d) Craft centre
- (e) Internet cafe
- (f) Chartered accountancy firm

#### Answer

For (a) Grocery store, (b) Medical store, (d) Craft centre, (e) Internet cafe sole proprietorship form of organisation would be more suitable because of low capital required, less risk involved and quick decision making.

2. For which of the following types of business do you think a partnership form of organisation would be more suitable, and why?

- (a) Grocery store
- (b) Medical store
- (c) Legal consultancy
- (d) Craft centre
- (e) Internet cafe
- (f) Chartered accountancy firm

#### Answer

For (c) Legal consultancy and (f) Chartered accountancy firm partnership form of organisation would be more suitable because of high managerial ability and comparatively wide range of operations.

3. Explain the following terms in brief

- (a) Perpetual succession

- (b) Common seal
- (c) Karta
- (d) Artificial person

### **Answer**

(a) 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.

(b) Common seal: As company is an artificial person, it cannot sign any documents hence, it uses common seal in place of signatures. Any agreement which does not have the company seal put on it is not legally binding on the company.

(c) Karta: Karta is the eldest member of the family and has unlimited liabilities along with absolute decision-making powers. The karta of a Joint Hindu family is responsible for carrying out the business operations of the family business and exercising full control over the business.

(d) Artificial person: Company is an artificial person but its rights, liabilities and functions are like natural person. It 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.

### **4. Compare the status of a minor in a Joint Hindu Family Business with that in a partnership firm.**

### **Answer**

In Joint Hindu Family Business, a male minor child become its member right after his birth in the family. The minor enjoys an equal ownership right over the inherited property as the other members of the family. However, his liability is limited only to the extent of his share in the joint property.

While in case of partnership, a minor can be admitted as a member only after moment of all other partners and that too only for benefits but he cannot be asked to either contribute capital or bear the losses incurred by the business. A minor is not legally competent to enter into any legal contracts, and therefore, he or she cannot be considered a partner. However, a minor, after attaining the age of 18

years, has the option of either continuing with the partnership firm or withdrawing his interest from it.

5. If registration is optional, why do partnership firms willingly go through this legal formality and get themselves registered? Explain.

### **Answer**

Although registration in case of a partnership firm is optional yet many firms voluntarily opt for it. This is because of the various legal disadvantages associated with non-registration. Some of them are:

→ The partners of a non-registered firm cannot file a suit against a third party; however, non-registration of a partnership firm does not prevent other firms from suing it .

→ The firm cannot file a case against any of its partners. Similarly, a partner of a non-registered firm cannot file a case against his or her co-partners or the firm.

→ A non-registered partnership firm cannot enforce its claims against a third party in a court.

6. State the important privileges available to a private company.

### **Answer**

The important privileges available to a private company are:

→ A private company can be formed by only two members whereas seven people are needed to form a public company.

→ There is no need to issue a prospectus as public is not invited to subscribe to the shares of a private company.

→ Allotment of shares can be done without receiving the minimum subscription.

→ A private company can start business as soon as it receives the certificate of incorporation. The public company, on the other hand, has to wait for the receipt of certificate of commencement before it can start a business.

→ A private company needs to have only two directors as against the minimum of three directors in the case of a public company.

→ A private company is not required to keep an index of members while the same is necessary in the case of a public company.

→ There is no restriction on the amount of loans to directors in a private company. Therefore, there is no need to take permission from the government for granting the same, as is required in the case of a public company.

**7. How does a cooperative society exemplify democracy and secularism? Explain.**

**Answer**

In a cooperative society, one person has one vote irrespective of numbers of shares held by them. This means that all members have equal voting rights hence, there is a complete democratic set up in the management and all the decisions are taken by the members of the society on the basis of majority.

The membership of company is open and not restricted and there is no discrimination among the members on the basis of their religion, caste or sex. Therefore, a cooperative society exemplifies a secularist system.

**8. What is meant by 'partner by estoppel'? Explain.**

**Answer**

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.

Page No: 53

**Long Answer Questions**

**1. What do you understand by a sole proprietorship firm? Explain its merits and limitation?**

## **Answer**

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.

Merit of sole proprietorship firm are:

- Quick decision making: A sole proprietor enjoys considerable degree of freedom in making business decisions.
- Ease of formation and closure: There are hardly any legal formalities to be fulfilled for setting up a sole proprietorship firm. 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.
- Sense of accomplishment: There is a personal satisfaction involved in working for oneself. This also instils in the individual a sense of accomplishment and confidence in one's abilities.
- Direct incentive: A sole proprietor is the single recipient of all the profits and gains earned in the business. This motivates the sole proprietor to operate the business efficiently and effectively.

Limitations of sole proprietorship firm are:

- 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. Therefore, business not grows much and generally remains small.
- Limited life of a business concern: In the eyes of the law the proprietorship and the owner are considered one and the same. Death, insolvency or illness of a proprietor affects the business and can lead to its closure.
- 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.
- Limited managerial abilities: A sole proprietor manages all the core functions

such as purchasing, selling, financing, etc. Also, due to limited resources, sole proprietor may not be able to employ and retain talented and ambitious employees.

**2. Why is partnership considered by some to be a relatively unpopular form of business ownership? Explain the merits and limitations of partnership.**

### **Answer**

Partnership is considered to be a relatively unpopular form of business ownership because of the various limitations associated with it. These limitations include unlimited liability, limited resources, possibility of conflicts and lack of continuity.

Merits of Partnership are:

- Ease of formation and closure: A partnership firm can be formed easily by putting an agreement between the prospective partners. There is no compulsion with respect to registration of the firm. Closure of the firm too is an easy task.
- Balanced decision making: The partners can oversee different functions according to their areas of expertise. This makes the decision-making process in a partnership firm comparatively more balanced than in any other form of business ownership.
- 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.
- 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.
- 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 of Partnership are:

- 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.
- 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.

→ Possibility of conflicts: In a partnership firm, the power of decision making is shared among the partners. This further depends on their respective levels of skills, capabilities and foresightedness. The differences in these qualities may possibly lead to conflicts among the partners.

→ Lack of continuity: Partnership comes to an end with the death, retirement, insolvency or lunacy of any partner. However, the remaining partners can enter into a fresh agreement and continue to run the business.

→ Lack of public confidence: A partnership firm is not legally required to publish its financial reports or make other related information public. As a result, the confidence of the public in partnership firms is generally low.

**3. Why is it important to choose an appropriate form of organisation? Discuss the factors that determine the choice of form of organisation.**

### **Answer**

It is important to choose an appropriate form of business organization because if one is planning to start a business or is interested in expanding an existing one, one important decision relates to the choice of the form of organization.

A business firm can be owned & managed in several forms. Once a form of business is chosen it is difficult to change it. Therefore, the form of business enterprise should be selected with due care & thought.

The factors that determine the choice of form of organisation are:

→ Cost and Ease of Starting Business: Sole proprietorship is started easily as far as initial business setting-up costs and legal requirements are concerned, in case of partnership also, the advantage of less legal formalities and lower cost is there because of limited scale of operations. Registration is compulsory in case of co-operative societies and companies. Formation of a company involves a lengthy and expensive legal procedure.

→ Liability: In case of sole proprietorship and partnership firms, the liability of the owners/partners is unlimited. This may result in payment of debt from personal

assets of the owners. In joint Hindu family business, only the karta has unlimited liability. In co-operative societies and companies, however, liability is limited and creditors can force payment of their claims only to the extent of the company's assets.

→ Continuity: The continuity of sole proprietorship and partnership firms is affected by events such as death, insolvency or insanity of the owners. However, such factors do not affect the continuity of business in the case of organizations like joint Hindu family business, co-operative societies and companies.

→ Managerial Ability: It is difficult for a sole proprietor to have expertise in all functional areas of business. In other forms of organizations like partnership and company, there is division of work among the members which allows the managers to specialize in specific areas, leading to better decision making. But this may sometimes lead to conflicts due to differences of opinion. Company form of organization is a better alternative if the operations are complex in nature and require professional management.

→ Capital Requirements: For large scale operations, company form are the most suitable as large amount of funds can be arranged by issuing shares in this form. For medium and small sized business, one can opt for partnership or sole proprietorship. Capital requirements for expansion can also be met more easily in company form.

→ Degree of Control: Sole proprietorship provides direct control over operations and absolute decision making power. But if the owners want to share control for more effective decision making, partnership or company form of organization can be adopted. In company form of organization, professionals are appointed to manage the affairs of a company as there is complete separation of ownership and management.

→ Nature of Business: Sole proprietorship is more suitable for businesses in which direct personal contact is needed with the customers such as in the case of a beauty parlor or grocery store. The company form of organization is suited for large manufacturing units. Partnership form is much more suitable in case of professional services. The factors stated above are inter-related and therefore, all the relevant factors must be taken into consideration while making a decision with respect to the form of organization..

#### 4. Discuss the characteristics, merits and limitations of cooperative form of

organisation. Also describe briefly different types of cooperative societies.

## **Answer**

Characteristics of cooperative form of organisation are:

- 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.
- 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.
- Limited liability: The liability of the members of a cooperative society is limited to the extent of the amount contributed by them as capital.
- Control: The power to take decisions lies in the hands of an elected managing committee which is elected by all the members of society by 'one man one vote' system.
- Service motive: The prime purpose of society lays emphasis on the values of mutual help and welfare. Hence, the motive of service dominates its working.

Merits of cooperative form of organisation are:

- Equality in voting status: The principle of 'one man one vote' governs the cooperative society irrespective of capital invested by them.
- Limited liability: The liability of members of a cooperative society is limited to the extent of their capital contribution.
- Stable existence: Death, bankruptcy or insanity of the members do not affect continuity of a cooperative society.
- 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.
- 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.

Limitations of cooperative form of organisation are:

→ Limited resources: Resources of a cooperative society consists of capital contributions of the members with limited means.

→ Inefficiency in management: Cooperative societies are unable to attract and employ expert managers because of their inability to pay them high salaries.

→ 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.

→ 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.

→ Differences of opinion: Internal quarrels arising as a result of contrary viewpoints may lead to difficulties in decision making.

Types of cooperative form of organisation are:

→ Consumer cooperative societies: These are formed to provide consumer goods at reasonable prices to its members.

→ Producer cooperative societies: The objective of producer cooperative societies is to procure raw materials and other inputs at low costs and supply them to small producers.

→ Marketing cooperative societies: These societies pool the outputs of the member and perform certain marketing functions for them such as transportation, labelling, packaging and warehousing.

→ Farmers' cooperative societies: Such societies are formed by small farmers who pool their resources to reap the benefits associated with large-scale operations. These societies ensure the availability of better and advanced inputs at low rates to farmers.

→ Credit cooperative societies: These societies ensure the availability of funds to

its members at comparatively low interest rates on reasonable terms.

→ Cooperative housing societies: These 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.

### 5. Distinguish between a Joint Hindu family business and partnership.

#### Answer

Basis of difference	Joint Hindu Family Business	Partnership
Governance	Governed by the Hindu law.	Governed by Partnership Act, 1932.
Liability	The head has unlimited liability, while the liabilities of other members are limited to the extent of their share in the business.	All the partners have unlimited liability.
Decision making and control	The <i>karta</i> is responsible for the management and control of the business.	All the partners jointly manage and control the firm.
Number of members	Minimum: 2 Maximum: No limit	Minimum: 2 Maximum: 10 for the banking business and 20 for other businesses
Minor	Minors can be members.	Minors cannot be members.

### 6. Despite limitations of size and resources, many people continue to prefer sole proprietorship over other forms of organisation? Why?

#### Answer

There are many benefits of sole proprietorship over other forms of organisation.

Therefore, many people continue to prefer it. Some of them are:

→ Ease of formation and closure: There are hardly any legal formalities to be fulfilled for setting up a sole proprietorship firm. 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.

→ Quick decision making: A sole proprietor enjoys considerable degree of freedom in making business decisions.

→ Direct incentive: A sole proprietor is the single recipient of all the profits and gains earned in the business. This motivates the sole proprietor to operate the business efficiency and effectively.

→ Flexibility in operations: A sole proprietorship firm is highly flexible in operations. It can adapt itself to various situations, and vital changes can be incorporated, as per the dynamism of the business environment. The reason for the high degree of flexibility can be attributed to the fact that a sole proprietor is the only person who is involved in every aspect of the business