

Revision Notes

CHAPTER : 2

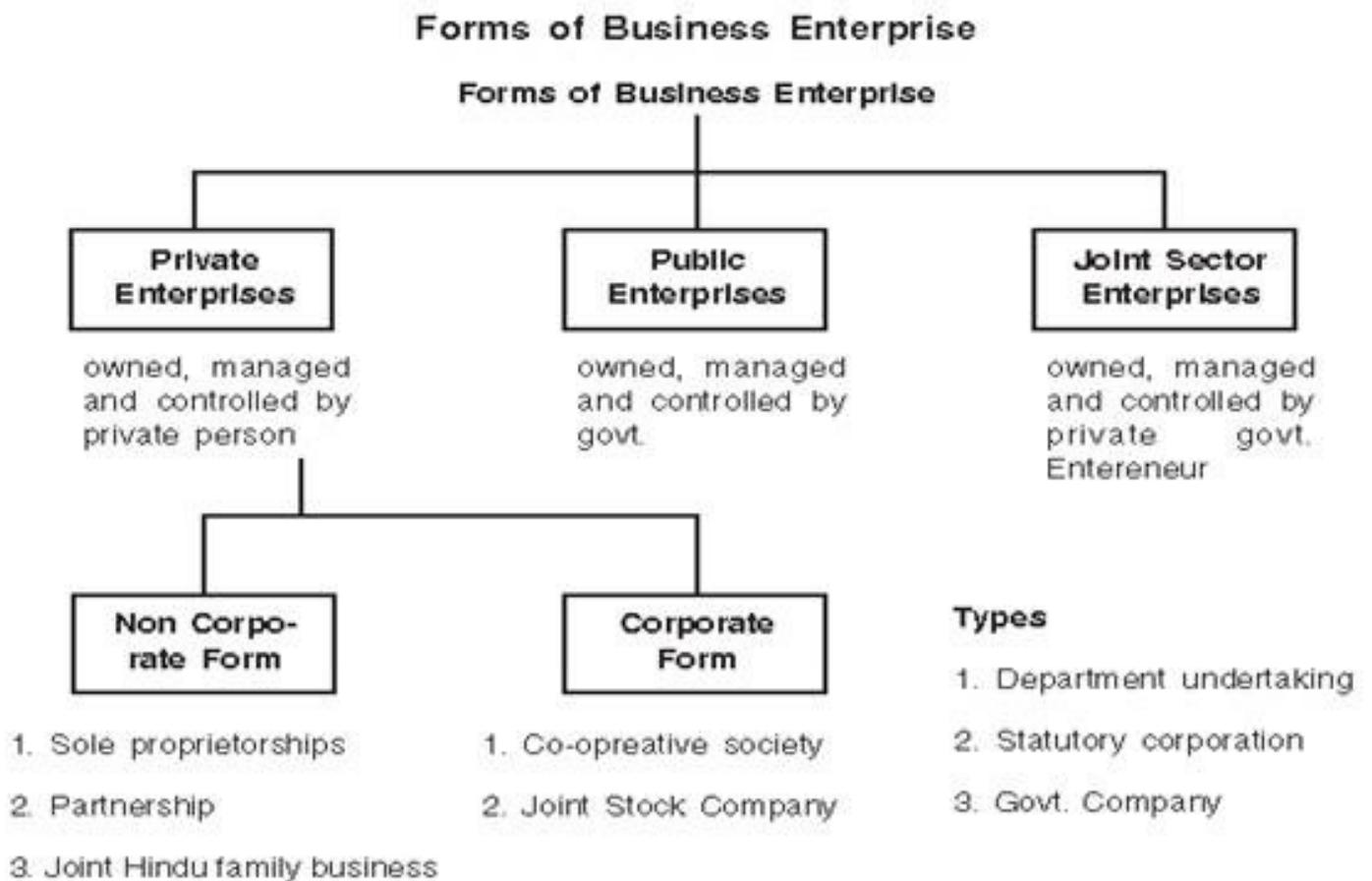
FORMS OF BUSINESS ORGANISATION

Meaning

A business enterprise is an institutional arrangement to form any business activity.

Classification

On the basis of ownership business enterprises can broadly be classified into the following categories:



In case of CORPORATE FORM of private enterprises the identity of the enterprise is separate from that of the owner and in case of NON CORPORATE FORM, the identity of the enterprise is not different from that of its owners.

Sole Proprietorship

Sole proprietorship means a business owned, financed and controlled by a single person who is recipient of all profit and bearer of all risks.

It is SUITABLE IN AREAS OF PERSONALISED SERVICE like beauty parlour, hair cutting saloons & small scale activities like retail shops.

Features

- 1. Single ownership:** It is wholly owned by one individual.
- 2. Control:** Sole proprietor has full power of decision making.
- 3. No separate legal entity:** Legally there is no difference between business & businessmen.
- 4. Unlimited liability:** The liability of owner is unlimited. In case the assets of business are not sufficient to meet its debts, the personal property of owner can be used for paying debts
- 5. No legal formalities:** Not required to start, manage and dissolve such business organization.
- 6. Sole risk bearer and profit recipient:** He bears the complete risk and there is no body to share profit/loss with him.

Merits

- 1. Easy to start and close:** It can be easily started and closed without any legal formalities.
- 2. Quick decision making:** As sole trader is not required to consult or inform anybody about his decisions.
- 3. Sense of accomplishment:** There is a sense of personal satisfaction.
- 4. Unlimited liability:** The liability of owner is unlimited. In case the assets of business are not sufficient to meet its debts, the personal property of owner can be used for paying debts
- 5. No legal formalities:** are required to start, manage and dissolve such business organization.
- 6. Sole risk bearer and profit recipient:** He bears the complete risk and there is no body to share profit/loss with him.

LIMITATIONS

- 1. Limited financial resources:** Funds are limited to the owner's personal savings and his borrowing capacity.
- 2. Limited Managerial ability:** Sole trader can't be good in all aspects of business and he

can't afford to employ experts also.

3. Unlimited liability: Ofcourse, sole trader compels him to avoid risky and bold business decisions.

4. Uncertain life: Death, insolvency, lunacy or illness of a proprietor affects the business and can lead to its closure.

5. Limited scope for expansion:- Due to limited capital and managerial skills, it cannot expand to a large scale.

SUITABILITY:

Sole tradership is suitable-

- Where the personal attention to customer is required as in tailoring, beauty parlour.
- Where goods are unstandardized like artistic jewellery.
- Where modest capital and limited managerial skills are required as in case of retail store
- Business where risk is not extensive i.e. lesser fluctuation in price and demand i.e. stationery shop.

JOINT HINDU FAMILY BUSINESS

It is owned by the members of undivided joint Hindu family and managed by the eldest member of the family known as KARTA. It is governed by the provisions of Hindu law. The basis of membership is birth in a particular family.

FEATURES

1. Formation - For a joint Hindu family business there should be at least two members in the family and some ancestral property to be inherited by them.

2. Membership by birth -

There are two systems which govern membership

Dayabhaga System- It prevails in west Bengal and allows both male and female member to co-parceners.

Mitakshara System- It prevails all over India except West Bengal and allows only male members to be coparceners.

3. Liability - Liability of Karta is unlimited but of all other members is limited to the extent

of their share in property

4. Continuity - The business is not affected by death or incapacity of Karta in such cases the next senior male member becomes the Karta.

5. Minor members - A minor can also become full fledged member of Family business.

MERITS

1. Effective control- The Karta can promptly take decisions as he has the absolute decision making power.

2. Continued business existence- The death, Lunacy of Karta will not affect the business as next eldest member will then take up the position.

3. Limited liability - The liability of all members except Karta is limited. It gives them a relief.

4. Secrecy - Complete secrecy regarding business decisions can be maintained by Karta.

5. Loyalty and Co-operation: It helps in securing better co-operation and greater loyalty from all the members who run the business.

LIMITATION

1. Limited capital: There is shortage of capital as it is limited to the ancestral property.

2. Unlimited liability of karta - It makes him less enterprising.

3. Dominance of karta - Karta manages the business and sometimes he ignores the valuable advice of other members. This may cause conflict among the members and may lead to break down of the family limit.

4. Hasty decisions: As karta is overburdened with work, he may take hasty and unbalanced decisions.

5. Limited managerial skills of karta also pose a serious problem. The Joint Hindu family business is on decline because of the diminishing no. of joint Hindu families in the country.

PARTNERSHIP

Meaning: Partnership is a voluntary association of two or more persons who agree to carry on some business jointly and share its profits and losses.

FEATURES

- 1. Two or more persons:** There must be at least two persons to form a partnership. The maximum no. of persons is 10 in banking business and 20 in non-banking business.
- 2. Agreement:** It is an outcome of an agreement among partners which may be oral or in writing.
- 3. Lawful business-** It can be formed only for the purpose of carrying on some lawful business.
- 4. Decision making & control** - Every partner has a right to participate in management & decision making of the organisations.
- 5. Unlimited liability** - Partners have unlimited liability.
- 6. Mutual Agency** - Every partner is an implied agent of the other partners and of the firm. Every partner is liable for acts performed by other partners on behalf of the firm.
- 7. Lack of continuity** - Firms existence is affected by the death, Lunacy and insolvency of any of its partner. It suffers from lack of continuity.

MERITS

- 1. Ease of formation & closure** - It can be easily formed. Only an agreement among the partners is required.
- 2. Larger financial resources** - There are more funds as capital is contributed by no. of partners.
- 3. Balanced Decisions** - As decisions are taken jointly by partners after consulting each other.
- 4. Sharing of Risks** - In it, risk get distributed among partners which reduces anxiety, burden and stress on individual partner.
- 5. Secrecy** - Secrecy can be easily maintained about business affairs as they are not required to publish their accounts or to file any report to the govt.

LIMITATIONS

- 1. Limited resources** - There is a restriction on the number of partners and hence capital contributed by them is also limited.
- 2. Unlimited liability-** The liability of partners is unlimited and they are liable individually as well as jointly. It may prove to be a big 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.

3. Lack of continuity - Partnership comes to an end with the death, retirement, insolvency or lunacy of any of its partner.

4. Lack of public confidence - Partnership firms are not required to publish their reports and accounts. Thus they lack public confidence.

TYPES OF PARTNERS

1. General / Active Partner - Such a partner takes active part in the management of the firm.

2. Sleeping or Dormant Partner - He does not take active part in the management of the firm. Though he invested money, shares profit & Loss and unlimited liability.

3. Secret Partner - He participates in business secretly without disclosing his association with the firm to general public. His liability is also unlimited.

4. Nominal Partner - Such a partner only gives his name and goodwill to the firm. He neither invests money nor takes profit. But his liability is unlimited.

5. Partner by Estoppels - He is the one who by his words or conduct gives impression to the outside world that he is a partners of the firm whereas actually he is not. His liability is unlimited towards the third party who has entered into dealing with firm on the basis of his pretensions.

6. Partner by holding out - He is the one who is falsely declared partner of the firm whereas actually he is not. And even after becoming aware of it, he-does not deny it. His liability is unlimited towards the party who has deal with firm on the basis of this declaration.

Minor as a Partner

A minor is a person who has not attained the age of 18 years. Since a minor is not capable of enlarging into a valid agreement. He cannot become partner of firm. However, a minor can be admitted to the benefits of an existing partnership firm with the mutual consent of all other partners. He cannot be asked to bear the losses. His liability will be limited to the exilent of the capital contributed by him. He will not be eligible to take an active part in the management of the firm.

Types of Partnership

A. Classification on the Basics of Duration

Partnership at will- This type of partnership exists at the will of partners.

Particular Partnership-This type of partnership is formed for a specified June period to accomplish a particular project (consolation of building)

B. Classification on the basis of Liability

General partnership-This liability of partners is limited and joint. Registration of firm is optional.

Limited Partnership-The liability of at least one partner is unlimited whereas the other partners may have limited.

Registration of firm is compulsory.

PARTNERSHIP DEED

The written agreement on a stamped paper which specifies the terms and conditions of partnership is called the partnership deed.

It generally includes the following aspects –

- Name of the firm
 - Location / Address of the firm
 - Duration of business.
 - Investment made by each partner.
 - Profit sharing ratio of the partners
 - Terms relating to salaries, drawing, interest on capital and interest on drawing of partners.
 - Duties & obligations of partners.
 - Terms governing admission, retirement & expulsion of a partner, preparation on of accounts & their auditing.
 - Method of solving dispute
-

REGISTRATION OF PARTNERSHIP

Registration is not compulsory it is optional. But it is always beneficial to get the firm registered. The consequences of non-registration of a firm are as follows:

-
- A partner of an unregistered firm cannot file suit against the firm or the partner.
 - The firm cannot file a suit against third party.
 - The firm cannot file a case against its partner.
-

Co-operative Society

A co-operative society is a voluntary association of persons of moderate means who unite together to protect & promote their common economic interests.

FEATURES

- 1. Voluntary association:** Every one having a common interest is free to join a co-operative society and can also leave the society after giving proper notice.
- 2. Legal status:** Its registration is compulsory and it gives it a separate legal identity.
- 3. Limited liability:** The liability of the member is limited to the extent of their capital contribution in the society.
- 4. Democratic control:** Management & Control lies with the managing committee elected by the members by giving vote. Every member has one vote irrespective of the number of shares held by him.
- 5. Service motive:** The main aim is to serve its members and not to maximize the profit.
- 6. Bound by govt.'s rules:** They have to be tide by the rules and regulations framed by govt. for them.
- 7. Distribution of surplus:** The profit is distributed on the basis of volume of business transacted by a member and not on the basis of capital contribution of members.

MERITS

- 1. Excise of formation:** It can be started with minimum of 10 members. Registration is also easy as it requires very few legal formations.
- 2. Limited Liability:** The liability of members is limited to the extent of their capital

contribution.

3. Stable existence: Due to registration it is a separate legal entity and is not affected by the death, luxury or insolvency of any of its member.

4. Economy in operations: Due to elimination of middlemen and voluntary services provided by its members.

5. Government Support: Govt. provides support by giving loans at lower interest rates, subsidies & by charging less taxes.

6. Social utility: It promotes personal liberty, social justice and mutual cooperation. They help to prevent concentration of economic power in few hands.

LIMITATIONS

1. Shortage of capital - It suffers from shortage of capital as it is usually formed by people with limited means.

2. Inefficient management - Co-operative society is managed by elected members who may not be competent and experienced. Moreover, it can't afford to employ expert and experienced people at high salaries.

3. Lack of motivation - Members are not inclined to put their best efforts as there is no direct link between efforts and reward.

4. Lack of Secrecy - Its affairs are openly discussed in its meeting which makes it difficult to maintain secrecy.

5. Excessive govt. control - it suffers from excessive rules and regulations of the govt. It has to get its accounts audited by the auditor and has to submit a copy of its accounts to registrar.

6. Conflict among members - The members are from different sections of society with different viewpoints. Sometimes when some members become rigid, the result is conflict.

TYPES OF CO-OPERATIVE SOCIETIES

1. Consumers co-operative Society - It formed to protect the interest of consumers. It seeks to eliminate middleman by establishing a direct link with the producers. It purchases goods

of daily consumption directly from manufacturer or wholesalers and sells them to the members at reasonable prices.

2. Producer's Co-operative Society - The main aim is to help small producers who cannot easily collect various items of production and face some problem in marketing. These societies purchase raw materials, tools, equipments and other items in large quantity and provide these things to their members at reasonable price.

3. Marketing Co-operative Society - It performs various marketing function such as transportation, warehousing, packing, grading, marketing research etc. for the benefit of its members. The production of different members is pooled together and sold by society at good price.

4. Farmer's Co-operative Society - In such societies, small farmers join together and pool their resources for cultivating their land collectively. Such societies provide better quality seeds, fertilizers, machinery and other modern techniques for use in the cultivation of crops. It provides them opportunity of cultivation on large scale.

5. Credit co-operative Society - Such societies protect the members from exploitation by money lenders. They provide loans to their members at easy terms and reasonably low rate of interest.

6. Co-operative Housing Society - The main aim is to provide houses to people with limited means/income at reasonable price.

JOINT STOCK COMPANY

Meaning - Joint stock company is a voluntary association of persons for profit, having a capital divided into transferable shares, the ownership of which is the condition of membership.

FEATURES

1. Incorporated association - The company must be incorporated or registered under the companies Act 1956. Without registration no company can come into existence.

2. Separate Legal Existence - It is created by law and it is a distinct legal entity independent

of its members. It can own property, enter into contracts, can file suits in its own name.

3. Perpetual Existence - Death, insolvency and insanity or change of members as no effect on the life of a company. It can come to an end only through the prescribed legal procedure.

4. Limited Liability - The liability of every member is limited to the nominal value of the shares bought by him or to the amt. guaranteed by him. Transferability of shares - Shares of public Co. are easily transferable. But there are certain restrictions on transfer of share of private Co. Common Seal- It is the official signature of the company and it is affixed on all important documents of company.

5. Separation of ownership and control - Management of company is in the hands of elected representatives of shareholders known individually as director and collectively as board of directors.

MERITS

1. Limited Liability - Limited liability of shareholder reduces the degree of risk borne by him.

2. Transfer of Interest - Easy transferability of shares increases the attractiveness of shares for investment.

3. Perpetual Existence - Existence of a company is not affected by the death, insanity, Insolvency of member or change of membership. Company can be liquidated only as per the provisions of companies Act.

4. Scope for expansion - A company can collect huge amount of capital from unlimited no. of members who are ready to invest because of limited liability, easy transferability and chances of high return.

5. Professional management - A company can afford to employ highly qualified experts in different areas of business management.

LIMITATIONS

1. Legal formalities - The procedure of formation of Co. is very long, time consuming,

expensive and requires lot of legal formalities to be fulfilled.

2. Lack of secrecy - It is very difficult to maintain secrecy in case of public company, as company is required to publish and file its annual accounts and reports.

3. Lack of Motivation - Divorce between ownership and control and absence of a direct link between efforts and reward lead to lack of personal interest and incentive.

4. Delay in decision making - Red tapism and bureaucracy do not permit quick decisions and prompt actions. There is little scope for personal initiative.

5. Oligarchic management - Co. is said to be democratically managed but actually managed by few people i.e. board of directors. Sometimes they take decisions keeping in mind their personal interests and benefit, ignoring the interests of shareholders and Co.

TYPES OF COMPANIES

On the basis of ownership, companies can be divided into two categories – Private & Public.

Difference between Private Company & Public Co.

Private Co.	Public Co.
It has minimum 2 and maximum 50 members.	It has minimum 7 and maximum unlimited.
It cannot invite general public to buy its shares and debentures.	It invites general public to buy its shares and debentures.
There are certain restrictions on transfer of its shares.	Its shares are freely transferable.
It can commence business after incorporation.	It can commence business after obtaining certificate of commencement of business.
It has to write Private Ltd. After its name Ex- Tata Sons, Citi Bank, Hyundai Motor India.	It has to write only limited after its name Ex- Reliance Industries Ltd., Wipro Ltd. , Raymond's Ltd.

In its minimum capital required is one lakh.	In its minimum capital required is five lakhs.
--	--

FORMATION OF A COMPANY

Formation of a company means bringing a company into existence and starting its business. The steps involved in the formation of a company are:

(i) Promotion

(ii) Incorporation

(iii) Capital subscription

(iv) Commencement of business.

A private company has to undergo only first two steps but a public company has to undergo all the four stages.

1. Promotion:

Promotion means conceiving a business opportunity and taking an initiative to form a company.

Step in Promotion:

1. Identification of Business Opportunity : The first and foremost function of a promoter is to identify a business idea e.g. production of new product or service.

2. Feasibility Studies: After identifying a business opportunity the promoters undertake detailed studies of technical, Financial, Economic feasibility of a business.

3. Name Approval: After selecting the name of company the promoters submit an application to the Registrar of companies for its approval.

4. Fixing up signatories to the Memorandum of Association: Promoters have to decide about the director who will be signing the memorandum of Association.

5. Appointment of professional: Promoters appoint merchant bankers, auditors etc.

6. Preparation of necessary documents: The promoters prepare certain legal documents such as memorandum of Association, Articles of Association which have to be submitted to the Registrar of the companies.

2. Incorporation

Incorporation means registration of the company as body corporate under the companies Act 1956 and receiving certificate of Incorporation.

Steps for Incorporation

1. Application for incorporation: Promoters make an application for the incorporation of the company to the Registrar of companies.

2. Filing of necessary documents: Promoters files the following documents:

- (i) Memorandum of Association.
- (ii) Articles of Association.
- (iii) Statement of Authorized Capital
- (iv) Consent of proposed director.
- (v) Agreement with proposed managing director.
- (vi) Statutory declaration.

3. Payment of fees: Along with filing of above documents, registration fee has to be deposited which depends on amount of the authorized capital.

4. Registration: The Registrar verifies all the document submitted. If he is satisfied then he enters the name of the company in his Register.

5. Certificate of Incorporation: After entering the name of the company in the register. The Registrar issues a Certificate of Incorporation. This is called the birth certificate of the company.

III. Capital Subscription:

A public company can raise funds from the public by issuing shares and Debentures. For this it has to issue prospectus and undergo various other formalities:

Step required for raising funds from public:

- 1. SEBI Approval:** SEBI regulates the capital market of India. A public company is required to take approval from SEBI.
- 2. Filing of Prospectus:** Prospectus means any documents which invites offers from the public to purchase share and Debenture of the company.
- 3. Appointment of bankers, brokers, underwriters:** Banker of the company receive the application money. Brokers encourage the public to apply for the shares, underwriters are the person who undertake to buy the shares if these are not subscribed by the public. They receive a commission for underwriting.
- 4. Minimum subscription:** According to the SEBI guide lines minimum subscription is 90% of the issue amount. If minimum subscription is not received then the allotment cannot be made and the application money must be returned to the applicants within 30 days.
- 5. Application to Stock Exchange:** It is necessary for a public company to list their shares in the stock exchange therefore the promoters apply in stock exchange to list company shares.
- 6. Allotment of Shares:** Allotment of shares means acceptance of share applied. Allotment letters are issued to the shareholders. The name and address of the shareholders submitted to the Registrar.

IV. COMMENCEMENT OF BUSINESS:

To commence business a public company has to obtain a certificate of commencement of Business. For this the following documents have to be filled with the registrar of companies.

1. A declaration that 90% of the issued amount has been subscribed.
2. A declaration that all directors have paid in cash in respect of allotment of shares made to them.
3. A statutory declaration that the above requirements have been completed and must be signed by the director of company.

Important documents used in the formation of company:

1. Memorandum of Association - It is the principal document of a company. No company can be registered without a memorandum of association and that is why it is sometimes called a life giving document.

Contents of Memorandum of Association:

1. Name clauses - This clause contains the name of the company. The proposed name should not be identical or similar to the name of another existing company.

2. Situation clauses - This clause contains the name of the state in which the registered office of the company is to be situated.

3. Object clause - This clause defines the objective with which the company is formed. A company is not legally entitled to do any business other than that specified in the object clause.

4. Liability Clauses - This clause limits the liability of the members to the amount unpaid on the shares held by them.

5. Capital clause - This clause specifies the maximum capital which the company will be authorized to raise through the issue of shares called authorized capital.

2. Articles of Association:

The articles of Association are the rules for the internal management of the affairs of a company. The articles define the duties, rights and powers of the officers and the board of directors.

Contents of the Article:

1. The amount of share capital and different classes of shares.
2. Rights of each class of shareholders.
3. Procedure for making allotment of shares.
4. Procedure for issuing share certificates.
5. Procedure for forfeiture and reissue of forfeited shares.
6. Rules regarding casting of votes and proxy voting

-
7. Procedure for selection and removal of directors
 8. Dividend declaration and payment related rules
 9. Procedure for capital readjustment
 10. Procedure regarding winding up of the company.
-

2. Prospectus:

Prospectus means any document which invites deposits from the public to purchase share or debentures of a company.

Main contents of the Prospectus:

1. Company's name and the address of its registered office.
 2. The main object of the company
 3. The number and classes of shares.
 4. Qualification shares of the directors
 5. The name and addresses of the directors, managing director or manager.
 6. The minimum subscription which is 90% of the size of the issue.
 7. The time of opening and closing of the subscription list.
 8. The amt. payable on the application and allotment of each class of share.
 9. Underwriters to the issue.
 10. Merchant bankers to the issue.
-

2. Statement in Lieu of Prospectus:

A public company having a share capital may sometimes decide not to raise funds from the public because it may be confident of obtaining the required capital privately. In such case it will have to file a statement in lieu of prospectus with the Registrar of companies. It contains information much similar to that of a prospectus.

CHOICE OF FORM OF BUSINESS ORGANISATION

The following factors are important for taking decision about form of organization:

- 1. Cost and ease in setting up the organization:** Sole proprietorship is least expensive and can be formed without any legal formalities to be fulfilled. Company is also expensive with

lot of legal formalities.

2. Capital consideration: Business requiring less amount of finance prefer sole proprietorship & partnership form, where as business activities requiring huge financial resonances prefer company form.

3. Nature of business: If the work requires personal attention such as tailoring unit, cutting saloon, it is generally setup as a sole proprietorship. Unit engaged in large scale manufacturing are more likely to be organized in company form.

4. Degree of control desired: A person who desires full and exclusive control over business prefers proprietorship rather than partnership or company because control has to be shared in these cases.

5. Liability or Degree of Risk: Projects which are not very risky can be organized in the form of sole proprietorship partnership whereas the risky ventures should be done in company form of organization because the liability of shareholders is limited.