

Forms of business organization

Introduction: Business concerns are established with the objective of making profits. They can be established either by one person or by a group of persons in the private sector by the government or other public bodies in the public sector. A business started by only one person is called sole proprietorship. The business started by a group of persons can be either a Joint Hindu Family or Partnership or Joint Stock Company or a Co-operative form of organization.

Thus there are various forms of business organization

1. Sole Proprietorship
2. Joint Hindu Family Firm
3. Partnership Firm
4. Joint Stock Company
5. Co-operative Society

Forms of business organization are legal forms in which a business enterprise may be organized and operated.

These forms of organization refer to such aspects as ownership, risk bearing, control and distribution of profit. Any one of the above mentioned forms may be adopted for establishing a business, but usually one form is more suitable than other for a particular enterprise. The choice will depend on various factors like the nature of business, the objective, the capital required, the scale of operations, state control, legal requirements and so on.

Out of the forms of private ownership listed above the first three forms (1, 2, and 3) may be described as non corporate and the remaining (4 and 5) as corporate forms of ownership. The basic difference between these two categories is that a non-corporate form of business can be started without registration while a corporate form of business cannot be set up without registration under the laws governing their functioning.

Check your progress- 1

List out the various forms of business organization.

1. _____
2. _____
3. _____
4. _____
5. _____

Activity- 1

Identify the forms of organization of any seven organizations which you are familiar with and list out who heads them.

1. _____
2. _____
3. _____
4. _____
5. _____
6. _____
7. _____

Characteristics of an ideal form of organization

Before we discuss the features, merits and demerits of different forms of organization, let us know the characteristics of an ideal form of organization. The characteristics of an ideal form of organization are found in varying degrees in different forms of organization. The entrepreneur, while selecting a form of organization for his business, should consider the following factors.

- **Ease of formation:** It should be easy to form the organization. The formation should not involve many legal formalities and it should not be time consuming.
- **Adequacy of Capital:** The form of organization should facilitate the raising of the required amount of capital at a reasonable cost. If the enterprise requires a large amount of capital, the preconditions for attracting capital from the public are a) safety of investment b) fair return on investment and c) transferability of the holding.
- **Limit of Liability:** A business enterprise may be organized on the basis of either limited or unlimited liability. From the point of view of risk, limited liability is preferable. It means that the liability of the owner as regards the debts of the business is limited only to the amount of capital agreed to be contributed by him. Unlimited liability means that even the owners' personal assets will be liable to be attached for the payment of the business debts.
- **Direct relationship between Ownership, Control and Management:** The responsibility for management must be in the hands of the owners of the firm. If the owners have no control on the management, the firm may not be managed efficiently.
- **Continuity and Stability:** Stability is essential for any business concern. Uninterrupted existence enables the entrepreneur to formulate long-term plans for the development of the business concern.
- **Flexibility of Operations:** another ideal characteristic of a good form of organization is flexibility of operations. Changes may take place either in market conditions or the states'

policy toward industry or in the conditions of supply of various factors of production. The nature of organization should be such as to be able to adjust itself to the changes without much difficulty.

Sole Proprietorship

Meaning: A sole proprietorship or one man's business is a form of business organization owned and managed by a single person. He is entitled to receive all the profits and bears all risk of ownership.

Features: The important features of sole proprietorship are:

1. The business is owned and controlled by only one person.
2. The risk is borne by a single person and hence he derives the total benefit.
3. The liability of the owner of the business is unlimited. It means that his personal assets are also liable to be attached for the payment of the liabilities of the business.
4. The business firm has no separate legal entity apart from that of the proprietor, and so the business lacks perpetuity.
5. To set up sole proprietorship, no legal formalities are necessary, but there may be legal restrictions on the setting up of particular type of business.
6. The proprietor has complete freedom of action and he himself takes decisions relating to his firm.
7. The proprietor may take the help of members of his Family in running the business.

Advantages

1. Ease of formation: As no legal formalities are required to be observed.
2. Motivation: As all profits belong to the owner, he will take personal interest in the business.
3. Freedom of Action: There is none to interfere with his authority. This freedom promotes initiative and self-reliance.
4. Quick Decision: No need for consultation or discussion with anybody.
5. Flexibility: Can adapt to changing needs with comparative ease.
6. Personal Touch: comes into close contact with customers as he himself manages the business. This helps him to earn goodwill.
7. Business Secrecy: Maintaining business secrets is very important in today's competitive world.
8. Social Utility: Encourages independent living and prevents concentration of economic power.

Disadvantages

1. Limited resources: one man's ability to gather capital will always be limited.
2. Limited Managerial Ability
3. Unlimited Liability: Will be discouraged to expand his business even when there are good prospects for earning more than what he has been doing for fear of losing his personal

- property.
4. Lack of Continuity: uncertain future is another handicap of this type of business. If the sole proprietor dies, his business may come to an end.
 5. No Economies of Large Scale: As the scale of operations are small, the owner cannot secure the economies and large scale buying and selling. This may raise the cost of production.

Suitability of Sole Proprietorship Form

From the discussion of the advantages and disadvantages of sole proprietorship above, it is clear that this form of business organization is most suited where:

1. The amount of capital is small
2. The nature of business is simple in character requiring quick decisions to be taken
3. Direct contact with the customer is essential and
4. The size of demand is not very large.

These types of conditions are satisfied by various types of small business such as retail shops, legal or medical or accounting profession, tailoring, service like dry cleaning or vehicle repair etc. hence sole proprietor form of organization is mostly suitable for these lines of businesses. This form of organization also suits those individuals who have a strong drive for independent thinking and highly venturesome in their attitude.

Joint Hindu Family

Meaning

The Joint Hindu Family, also known as Hindu Undivided Family (HUF) is a non-corporate form of business organization. It is a firm belonging to a Joint Hindu Family. It comes into existence by the operations of law and not out of contract.

In Hindu Law, there are two schools of thought viz Dayabhaga which is applicable in Bengal and Assam, and Mitakshara which is applicable in the rest of India. According to Mitakshara school, the property of the Joint Hindu Family is inherited by a Hindu Family from his father, grandfather and great grandfather, thus three successive generations in male line (son, grandson and great grandson) can simultaneously inherit the ancestral propriety. They are called coparceners in interest and the senior most member of the Family is called karta. The Hindu succession act 1956, has extended to the line of co-parceners interest to female relatives of the deceased co-parcener or male relative climbing through such female relatives. Under the Dayabagha law the male heirs become members only on the death of the father.

Features

Some of the important features of the Joint Hindu Family are as follows

1. The business is generally managed by the father or some other senior member of the Family he is called the Karta or the manager.
2. Except the Karta, no other member of the family has any right of participation in the management of a Joint Hindu Family firm
3. The other members of the family cannot question the authority of the Karta and their only remedy is to get the family dissolved by mutual agreement.
4. If the Karta has misappropriated the funds of the business, he has to compensate the other co-parceners to the extent of their share in the Joint property of the family

5. For managing the business, the Karta has the power to borrow funds, but the other coparceners are liable only to the extent of their share in the business. In other words the authority is limited.
6. The death of any member of the family does not dissolve the business of the family
7. Dissolution of the Joint Hindu Family can take place only through mutual agreement

Advantages

1. **Stability:** The existence of the HUF does not come to an end with the death of any coparcener, hence there is stability.
2. **Knowledge and experience:** There is scope for younger members of the family to get the benefit of the knowledge and experience of the elder members of the family.
3. **No Interference:** The Karta has full freedom to take decisions without any interference by any member of the family.
4. **Maximum Interest:** As the Karta's liability is unlimited, he takes maximum interest in running the business.
5. **Specialization:** By assigning work to the members as per their knowledge and experience, the benefits of specialization and division of work may be secured.
6. **Discipline:** The firm provides an opportunity to its members to develop the virtues of discipline, self-sacrifice and co-operation.
7. **Credit Worthiness:** Has more credit worthiness when compared to that of a sole proprietorship.

Disadvantages

1. **No Encouragement:** As the benefit of hard work of some members is shared by all the members of the family, there is no encouragement to work hard.
2. **Lazy and Inactive:** The Karta takes the responsibility to manage the firm. This may result in the other members becoming lazy.
3. **Members Initiative:** The Karta alone has full control over the business and the other members cannot interfere with the management of the firm. This may hamper members initiative.
4. **Duration:** The life of the business is shortened if family quarrels take precedence over business interest.
5. **Abuse of Freedom:** There is scope for the Karta to misuse his full freedom in managing the business for his personal benefit.

Conclusion

This form of business organization which at one time was popular in India is now losing its popularity. The main cause for its decline is the gradual dissolution of the Joint Hindu Family system, it is being replaced by sole proprietorship or partnership firm.

Partnership Form of Organization

Generally when a proprietor finds it's difficult to handle the problems of expansion, he thinks of taking a partner. In other words, once a business grows beyond the capacity of a sole proprietorship and or a Joint Hindu Family, it becomes unarguably necessary to form partnership. It means that partnership grows out of the limitations of one-man business in terms of limited financial resources, limited managerial ability and unlimited risk.

Partnership represents the second stage in the evolution of ownership forms.

In simple words, a Partnership is an association of two or more individuals who agree to carry on business together for the purpose of earning and sharing of profits. However a formal definition is provided by the Partnership Act of 1932.

Definition

Section 4 of the Partnership Act, 1932 defines Partnership as “the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all”

Features of Partnership

1. simple procedure of formation: the formation of partnership does not involve any complicated legal formalities. By an oral or written agreement, a Partnership can be created. Even the registration of the agreement is not compulsory.
2. Capital: The capital of a partnership is contributed by the partners but it is not necessary that all the partners should contribute equally. Some may become partners without contributing any capital. This happens when such partners have special skills, abilities or experience. The partnership firm can also raise additional funds by borrowing from banks and others.
3. Control: The control is exercised jointly by all the partners. No major decision can be taken without consent of all the partners. However, in some firms, there may partners known as sleeping or dormant partners who do not take an active part in the conduct of the business.
4. Management: Every partner has a right to take part in the management of the firm. But generally, the partnership Deed may provide that one or more than one partner will look after the management of the affairs of the firm. Sometimes the deed may provide for the division of responsibilities among the different partners depending upon their specialization.
5. Duration of partnership: The duration of the partnership may be fixed or may not be fixed by the partners. In case duration is fixed, it is called as “partnership for a fixed term. When the fixed period is over, the partnership comes to an end.
6. Unlimited Liability: The liability of each partner in respect of the firm is unlimited. It is also joint and several and, therefore any one of the partner can be asked to clear the firm’s debts in case the assets of the firm are inadequate for it.
7. No separate legal entity: The partnership firm has no independent legal existence apart from that of the persons who constitute it. Partnership is dissolved when any partner dies or retires. Thus it lacks continuity.
8. Restriction on transfer of share: A partner cannot transfer his share to an outsider without the consent of all the other partners.

Advantages

1. ease of formation: partnership can be easily formed without expense and legal

- formalities. Even the registration of the firm is not compulsory.
2. large resources: when compared to sole-proprietorship, the partnership will have larger resources. Hence, the scale of operations can be increased if conditions warrant it.
 3. better organization of business; as the talent, experience, managerial ability and power of judgment of two or more persons are combined in partnership, there is scope for a better organisation of business.
 4. greater interest in business: as the partners are the owners of the business and as profit from the business depends on the efficiency with which they manage, they take as much interest as possible in business.
 5. prompt decisions: as partners meet very often, they take decisions regarding business policies very promptly. This helps the firm in taking advantage of changing business conditions.
 6. balance judgement: as partners possess different types of talent necessary for handling the problems of the firm, the decisions taken jointly by the partners are likely to be balanced.
 7. flexibility: partnership is free from legal restriction for changing the scope of its business. The line of business can be changed at any time with the mutual consent of the partners. No legal formalities are involved in it.
 8. diffusion of risk; the losses of the firm will be shared by all the partners. Hence, the share of loss in the case of each partner will be less than that sustained in sole proprietorship.
 9. protection to minority interest: important matters like change in the nature of business, unanimity among partners is necessary hence, the minority interest is protected.
 10. influence of unlimited liability: the principle of unlimited liability helps in two ways. First, the partners will be careful in their business dealings because of the fear of their personal properties becoming liable under the principle of unlimited liability. Secondly, it helps the firm in raising loans for the business as the financiers are assured of the realization of loans advanced by them.

Disadvantages.

1. great risk; as the liability is joint and several, any one of the partners can be made to pay all the debts of the firm. This affects his share capital in the business and his personal properties.
2. lack of harmony: some frictions, misunderstanding and lack of harmony among the partners may arise at any time which may ultimately lead to the dissolution.
3. limited resources: because of the legal ceiling on the maximum number of partners, there is a limit to the amount of capital that can be raised.
4. tendency to play safe: because of the principle of unlimited liability, the partners tend to play safe and pursue unduly conservative policies.
5. no legal entity: the partnership has no independent existence apart from that of the persons constituting it, i.e. it is not a legal entity.
6. instability: the death, retirement or insolvency of a partner leads to the dissolution of the partnership. Further even any one partner if dissatisfied with the business,

- can bring about the dissolution of partnership. Hence partnership lacks continuity
7. lack of public confidence: no legal regulations are followed at the time of the formation of partnership and also there is no publicity given to its affairs. Because of these reasons, a partnership may not enjoy public confidence.

sustainability: the advantages and drawbacks of partnership stated above indicate that the partnership form tends to be useful for relatively small business, such as retail trade, mercantile houses of moderate size, professional services or small scale industries and agency business.

But when compared to sole proprietorship partnership is suitable for a business bigger in size and operations.