UNIT V

FORMS OF BUSINESS OWNERSHIP

MAIN OBJECTIVE

To help students to understand various factors that influence the selection of the form of business ownership.

LEARNING OUTCOME

- To understand the salient features of four types of ownerships that are suitable for running MSMES
- To understand the advantage and disadvantages of form of business ownership.
- To understand the important considerations in the selection of an appropriate form of ownership structure for MSMES
- To understand the ownership patterns prevalent in Micro and Small enterprises in the country.

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- Sole Proprietorship
- Partnership
- Company
- Co-operative
- Selection of an appropriate form of Business Ownership

FORMS OF OWNERSHIP

The selection criteria of a proper form or type of a business unit or organization is crucial for the success of a business enterprise. When an entrepreneur decides to operate a business, the first question to be addressed is what legal form the business will take. Every entrepreneur has to decide at the outset, about the type of organization, which he plans to select for his private enterprise. This decision is by and large influenced by the socio-culture-financial-industrial environment and many other factors.

The Chief forms or types of business units, form ownership viewpoint are –

1. Sole proprietorship
2. Partnership
3. Co-operative society
4. Joint stock company

SOLE PROPRIETORSHIP

Introduction and meaning sole trading concern is the oldest form of commercial organization having a single owner, manager and controller of business. It is basically a one man Show. It Operate in a local market. The person conducting this business is called a 'Sole trader '. The sole trader can maintain personal contact with his customers. Therefore it is called personal organization.

FEATURES OF A SOLE TRADING CONCERN.

1) **Single ownership** :– A sole trading concern is a one man show. It is organized, owned and operated by a single individual. All properties or assets of business, therefore belong to the sole trader. As a single owner he enjoys absolute authority and control over business and its properties. In this sense, a sole trading concern is also knows as sole proprietorship.

2) **Self-Investment** :– The capital invested in a sole trading concern is entirely contributed by the sole trader himself. If he needs additional of ands, he may arrange of or the same by borrowing from his friends and relatives or from banks and other financial institution. This in this sense the sole proprietor undertakes the responsibility of fulfilling all financial needs of his business.

3) **Self-Management and Control :**– A sole trader himself manages the affairs of his business. In other words, control of all activities of the enterprise rest with him. He enjoy full freedom of taking decision and determining the policy of his business. Thus, there is unification or complete concentration of managerial and controlling power in a single individual.

4) **Unlimited Liability :**– A sole trader is fully responsible for all operations of his enterprise. He has therefore to bear the entire risk of losses in the business. This means his liability is unlimited. This require him to bear the loss over and above his capital investment. In other words if the capital invested in the business is not enough to pay off the liabilities then the personal assets of the proprietor will be utilized to do so.

5) **No sharing of profits and risks**– Just as entire risk is borne by sole proprietor himself the profits earned by the business also entirely belong to him. Since he alone contributes to the capital and runs the risk of business, he is fully entitled to the net profits of the organization with no one else sharing with him.

6)**Minimum Government Regulation**– Unlike other forms of organization, there are no special legislation to govern sole trading concern. There are no legal formalities either information or dissolution of the concern. Registration of sole trading concern is not compulsory. However, he must observe the law of the country in general. Any individual who is major in age, sound in mind and who is capable of raising the regained funds for the business can start a sole trading business.

8) No Separate Legal Entity – Unlike joint stock company, a sole trading concern does not enjoy legal entity separate form that of its proprietor. Legally the proprietor and the firm are identical in all business dealings. Hence continuity of business solely depends upon the life of the sole trader.

9) Local Business – The activities of a sole trader are generally confined to a limited area or locality. This shows that the business dealings are purely local in nature. This is mainly because of his limited capital and managerial ability. Financially also it is not

possible for a sole trader to undertake business on a large scale since his finance raising capacity is quite limited.

ADVANTAGES OF SOLE TRADING CONCERN

1) **Easy Formation**– The formation of a sole trading concern does not involve many legal formalities and thus its formation is an easy task. It can be established within a few days after deciding the nature of business to be carried out. Any person who is competent to enter into control and manage the affairs of business independently, can form an enterprise which saves time and efforts in formation.

2) **Personal Contacts**– A sole trader can develop personal contacts with his customers as well as employees. Having intirate contacts helps in knowing their likes and dislikes, tastes, habits, grievorees and in satisfying their needs. Thus in turn helps in promoting goodwill and market reputation of the proprietor.

3) **QUICK DECISION AND PROMPT ACTION**– Being the final authority in every respect, a sole trader can take immediate decisions on all important matters. He can also implement the decision promptly without any delay as he need not consult anybody else in his decision making process unless he seeks expect advice form on outsider.

4) **BUSINESS SECRECY** – Secrets of a business are secrets of its success. A sole trader can be guard his secrets since he need not disclose or publish his annual accounts as a Joint stock company is required to do. In this way Outsiders do not came to know his secrets policies and decision.

5) **FLEXIBILITY IN OPERATION**– A sole proprietor free to alter his polices and decisions. He can Easily expand or contract his activities as per his wish. He can switch over to any other line or diversify to other lines of activity. Since diversification is most important in modern business, flexibility enables the sole trader to diversify and introduce new activities in business.

6) **DIRECT MOTIVATION**– Since entire profits belongs to one proprietor he can take maximum interest and make utmost effort to further increase the profitability of his organization. There is direct relationship between effort and reward which serves as motivation for him to work hard.

7) **ECONOMY AND EFFICIENCY**– A sole trader attempt to minimize his expenditure and maximize returns on investment moreover, the proprietor himself devotes

maximum time and energy to his business. He can exercise close and effective control and personal supervision over all different affairs.

8) **PERSONALITY DEVELOPMENT**– There is vast scope for development of personality of a sole proprietor. He can develop certain personal Qualities like self-reliance, initiature, sense of responsibility etc. Since he always remains cautious because he knows that if he fails in business, he will himself have to bear all consequences.

9) **BETTER CO-ORDINATION** – The size of organization being limited a sole proprietor can easily Co-ordinate all factor of input in business. Since there is no change for conflict between various interest, he can maintain high sprit of team work among his employees by synchronize their function and efforts and directing the organization towards its final goal.

10) **Limited Government Control**– A sole trading concern is least affected by government regulations. There are no restriction on operation, expansion and dissolution of its business activity. Since the volume of his business is limited, his tax liability is also limited.

11) **Benefits of self-employment** – Sole Proprietorship serves as basis for independent livelihood for many individuals who possess limited financial resources, business ability and professional skills. It therefore serves as a means of self-employment to such individuals having limited resources at their disposal.

DISADVANTAGES OF A SOLE TRADING CONCERN

1) **Limited Capital**– A sole trader may have limited financial capacity as for as a investment is concerned. However he can borrow funds from outside source on his personal surety or by mortgaging his private property. But his borrowings capacity is also limited. Therefore sole trader cannot expand or develop his business beyond a particular limit. In fact modern business require huge amount of capital.

2) **Limited Managerial Ability –** Since there is only one person to manage all affairs of business, a sole trading concern has limited managerial organizational capacity.

It may not be always possible for single individual to possess financial resources as well as managerial ability. Besides managing itself is a difficult task on account of day by day growing complexities of business. It is therefore physically not possible for one single person to look after all the as peets of business.

3) **Unlimited Liability**- The liability of a sole trader being unlimited if business losses exceeds his capital, he may have to pay off business debts out of his personal property. His personal property is in danger of being lost in case of dissolution of business on account of persistent losses.

4) **Lack of Continuity and Stability**– The business of sole trader is unstable and gets adversely affected in the event of his death, insolvency insanity or physical in ability to conduct business. There can be no legal obligation on his successor to continue the same business. This is because the business of a sole trader does not enjoy separate legal status or entity.

5) **Absence of Economies of large scale** – A sole trader with his small resources is unable to reap the benefit of large scale economies. As a result of this, the cost operation is higher as compared with that of other large organization. Beside this factor acts as a handicap in progress of enterprise.

6) **Bargaining Power** – Due to limited finance at his disposal, a sole trader possess limited bargaining power. He is always at the mercy of whole scale for regular supply of goods. He is not in a position to bargain with them and this cannot take the benefit of favourable market situation on account of limited funds.

7) **Lack of Division of Labour** – A sole trader cannot adopt the principle of division of labour because of the small size of his establishment. As a result he cannot obtain the benefits of specialization which is the outcome of division of labour. Lack of Specialisation result in higher costs of managing affairs of business.

8) **Limited Scope for Expansion** – Additional capital and higher managerial skill are necessary for expansion of a business activity. Both these are the limitation of sole trader and therefore he has to keep his activities limited. Expansion of his business can take place with the help of borrowing from outside sources which becomes a costly affair for him.

9) **Limited Supervision**– Sole trader being the only person to look after all affairs of his organization may be lacking in supervising ability. It may not be possible for him to supervise all function as well as entire personal employed by him

PARTNERSHIP FIRM

Introduction – Partnership firm is a form of commercial organization came into existence due to limitation of sole trading concern. Thus a need was felt to have more financial resources, more managerial skills a high degree of specialization. The business risks properly spread over, sound and rational decision making.

Meaning

When two or more persons join hands to undertake an activity with the aim of earning profits and decide to jointly own and manage the business and share the profit and losses there, of it is called a partnership firm.

FEATURE OF A PARTNERSHIP FIRM

1) **Agreement** – Partnership is the result of voluntary agreement between persons to carry on the business for profits. Thus partnership does not emerge from birth states but from a contract partnership agreement contain term and conditions regarding internal management of partnership business.
2) **Lawful Business** – Partnership firm must conduct business for earning profit. It cannot under takes any business activity which is forbidden by law i.e which is illegal e.g indulging into smuggling activities.

3) **Sharing of Profit and Losses** – Partners share profits and losses in the agreed ratio as mentioned in the partnership Deed. If the partnership Deed is silent regarding the profit sharing ratio, it is assumed that partners are equal partners. A partner contributing large capital or taking very active part in management of business may be given more share of profits.
4) **Number of Partners** – The minimum number of partners required for forming a partnership is two. The maximum number of partner for conducting banking business is ___. However the maximum number of partners for conducting ordinary business is twenty.
5) **Joint Ownership** – All partners are Joint owners of business. Therefore all business assets and properties must be utilized for conducting business and not for personal use.
6) **Unlimited liability** – The liability of every partner of a firm is unlimited joint and several unlimited liability of a partner means that if the business assets are not sufficient to pay off the third party debts, no distinction will be made between the business and personal property of the partners to fully settle such liabilities.
7) **Restriction on Transfer of Interest** – Each partner becomes a partner in the firm on the basis of an agreement. No partner can be admitted into the firm without the concern of other partner. Similarly no partner can transfer his right to manage the business.
8) **Dissolution** – The death, insolvency or insanity of any partner result into dissolution of partnership in the absence of contrary prosdddd. The remaining partner may continue to conduct business on the basis of a fresh agreement among them. Partnership at will is compulsory dissolved when any partner serves a 14day notice to other partners.
9) **Joint Management** – All partners have equal managerial rights as per the Act. However for convenience some partner act as managing partners and other partners voluntarily surrender their managerial rights in favour of managing partners.
10) **Utmost Good Faith** – Partnership organization is based upon the spirit of corporation. Good faith and confidence among the partner. The partner should be loyal to one another and to the firm.
11) **Principal Agent Relationship** – Every part of the firm works in two capacities viz as an agent and as a principal. A partner is regarded to be an agent of a firm. Therefore every partner can act on behalf of the firm and bind other partner by his acts.

    Similarly every partner is the principal as he is the owner of the firm and therefore can be bound by the acts of other partners.

12) **Registration** – Registration of a partnership is optional thought it is advisable to get it registered since there are many disadvantages attached to an unregistered firm.

ADVANTAGES OF A PARTNERSHIP

1) **Easy Formation** – There are no legal restriction on the formation of a partnership – Any two or more persons who are competent to enter into contract can form a partnership by an oral or written agreement to carry on any lawful business. Less form alities and government regulation about formation of partnership is an important merit of this type of organization.
2) **Higher Capital Raising Capacity** – As there are more than one proprietors in a partnership, they can contribute a larger amount of capital. Thus a partnership has higher capacity to raise finance than that of a sole proprietorship.
3) **High Managerial Efficiency** – As there are more partners, managerial efficiency of a partnership firm enhances. The task of managing the affairs can be divided between all active partners. Thus each one of them can specialize in his own activity. It becomes easy to expand the business and control all its aspect.
4) **Quick Decisions and Prompt Action** – The process of taking decision and their implementation is prompt in a partnership business as partners can meet very often and take it possible for them to take the advantages of market condition whenever the same are favourable.
5) **Business Secrecy** – A partnership firm can maintain strict secrecy of business matters. It is not required to publish its annual account and balance sheet. Therefore there is no chance of any secret information being published unlike in case of a company organization.
6) **Operational Flexibilities** – A firm can take timely decision regarding expansion or contraction of business operation. It is not required to undergo any legal formality in making decision unlike in case of a company which is required to convene a general meeting of all shareholder. Besides, the business operation of a partnership firm have no government restrictions.
7) **Easy Dissolution** – A firm can be dissolved by any single party by giving 14 days notices to others. This means a firm can easily be wound up without undergoing any complicated procedure or formalities. Generally the partnership agreement provides a set of rules and regulation for the dissolution of the firm.
8) **Sound Policy and Decision** – It is said that two heads are always better than one partnership decision can be more accurate as compared to those of sole

proprietorship. In practice decision are taken by all partners collectively and their fore, they are likely to be more balanced.

9) **Division of Labour** – In partnership organization person possessing different talent and business skills can come to gather, making an effective combination of Uaried Qualities. Some partners may possess enough financial resources, some may possess managerial expertise and some may have sound technical knowledge.
10) **Business Goodwill** – Certain persons having good business reputation can be admitted to the benefits of partnership firm. Their association with the firm can boost its image in the market.
11) **Diffusion of Business Risks** – In partnership business risks get spread over various partners and each partner has to bear only a part of it. Since the gains of a partnership are shared by all partners business risk and losses are also shared by all of them.
12) **Effort –Reward Relationship** – There is a close relationship between effort and reward in partnership. If partners take greater initiative and interest there will be increased returns to the firm as well as individual partners. This induces them to maintain high level of business effiency.

DISADVANTAGES OF A PARTNERSHIP

1) **Limited Finance** – As compared with a sole proprietorship, a partnership firm may have higher finance raising capacity. But as compared with a joint stock and public enterprise, it has limited financial resources. This is because there is eeiling on the number of partner imposing limitation on the size of the firm and its activities. AA firms borrowing capacity may also be limited.
2) **Lack of Stability** – Unlike a joint stock company a partnership does not have perpetual succession. The business of a firm may come to end on account of death, insanity, insolvency or incompetence of any partner to enter into contract.
3) **Unlimited Liability** – Unlimited liability of partners acts as detrimental to large scale business involving greater risks. Even if one partner is negligent and careless, the business may suffer loss which has to be borne by all partners. Thus a substantial amount of risk is involved in a partnership business.
4) **Limited Managerial Capacity** – As compared with a company a partnership has limited managerial ability. It may not be feasible for a firm to avail of the services of professional managers. Since partnership has limited financial resources, experts or professional managers cannot be appointed to look after the business.
5) **No Legal Entity** – Unlike company, a partnership is not created by law. Hence it does not have a legal standing or status independent of that of its partners. The

partners and the firm are in separable from each other thus in the event of unusual circumstances like death, insolvency or insanity etc. the partnership discontinues.

6) **Non Transferability of Interest** – A partner cannot transfer his interest (share capital) in business to any other person without consent of other partners. Thus, investment made in partnership does not have required liquidity.
7) **Lack of Public Confidence** – Since partnership is not an organization created by law, the state does not have effective control over its functioning. A firm is not supposed to publish its annual accounts. The affairs of the firm are known to the partners only and not to any outsider. Due to this facts, a partnership may not win public confidence.
8) **Lack of a Central Controlling Authority** – In Partnership, all partners have equal rights duties and status. Every partner acts in the capacity of principal as well as agent of the firm. In the absence of mutual understanding between them differences of opianion may arise leaving to conflicts between partners.

9) **Absence of Delegation of Authority** – A partner cannot delegation his authority to any other person except to the other partner the cannot ask any outsider to act on his behalf. Delegation of authority is essential for smooth functioning of the organization.

CO-OPERATIVE SOCIETY

A Co-operative form of organization is based on the philosophy of self-help and mutual help. A co-operative society is an association of persons who have joined together on a voluntary basis for their common economic interest. It is not formed only for profit motive, but the prime motive is to protect the welfare of members as well as to protect its members form exploitation. In other words A Co-operative society is a voluntary association of persons formed for promoting some common objectives of its members. The main object is to pool small resources on collective basis and its uthisation for the benefit of members. A co-operative organization needs to be registered with the registrar of co-operative societies of the state in which the society's registered office is located. It should have a minimum number of 10 members and no limit for maximum number of members.
Characteristic's/features of co-operative societies. The following are some of the main features of co-operative societies.

1) **It is a Voluntary Association** – No one is forced to be a member of co-operatives. It is with full freedom and choice that people belonging to weaker sections from a particular

line come together to protect and promote their economic interests. It is an association of weak economically and socially to wage a war against all sorts of exploitation. It works of the principles of equality, liberty, and fraternity, because this one man one vote and not one share one vote. In co-operatives, man owns the capital but capital does not own the human-beings.

2) **Service Above Profit** – The main aim of co-operatives is to achieve the objectives of serving the cause of humanity. Profit is a secondary thing. That is why, very limited reward is given to share capital which is important is to serve the needs of members. Thus in case of farmers society it is to provide inputs and implements at cheaper rates of superior quality, in case of credit co-operatives, the aim is to make available finance at lower rates than commercial banks, in case of consumer co-operatives, to provide provisions at least price of better quality and so on.

3) **Distributive Justice** – Though aim is not to earn the profits, profits or surplus is taken as a hallmark of better performance. However, the surplus is distributed not according to the capital but according to the patronage extended to the society. That is, after giving a standard lower rate to capital, and after keeping aside standard rates of reserves, the surplus is distributed commensurate with his extension of co-operation in dealing with the society.

4) **Political and Religions Neutrality** – It is a Voluntary organization for working together for common good economic and social upliftment. The paradox 'united we stand divided we fall' that applies. Co-operative venture speaks of universal solidarity and brotherhood irrespective of differences in political and religions ideologies. That is, all are above caste, colour, political affinity, locality, ethnicism and religion. All are equal unity is the strength.

5) **Co-operative Education** – The co-operators need education. Co-operative education to its members and non-members is a precondition to realize the benefits of co-operative principles and the success of co-operative venture. Co-operators are members, officer bearers, executives and the employers where all need co-operative education and trading. The ideology and the philosophy is to be given a wide publicity and propaganda as its benefits are not known to many people. That is, education co-operative fold is so important that it become a feature itself.

JOINT STOCK COMPANY

With the enlargement of the scale of business operations it becomes difficult for sole proprietorship or partnership to cope with the problem of finding major resources and arranging for more specialized management such problems can be solved by joint stock company form of organization.

A joint stock company is a voluntary association of persons who contribute to its capital but their liabilities are limited. A company exists as a separate legal entity. Its capital is in the form of transferable shares. If has a common seal and permanent existence.

The following are some of the main features of a joint stock company from of organization.

1) **It is Body Corporate** – Body corporate mean an association of persons representing a body which is incorporation or registered under the provision of Companies Act. Joint Stock Company is formed by incorporation. Indian companies are registered under Indian Companies Act of 1956. A company has an independent name like a natural person which is displayed at the place of its business, all its papers and documents. I has a common seal. Like a natural person, it cannot sign the papers and documents. Hence, it has to have the company's seal in the place of signature. To avoid its misuse, it is counter-signed or witnessed by at least two directors wherever seal is used.
2) **It is an Artificial Person** – By its very nature, company is an artificial person created by law. It takes birth by legal procedure. It enjoys independent legal personally which is invisible, intangible and existing only in the eyes of law. It is not fictitious because it exists. Like natural person it can enter into contracts, purchase and sell the assets, and property, appoint persons as employees. With distinct from, its members and directors or shareholders with whom it can enter into contract. As it enjoys a separate legal existence, the shareholders, the owned are not liable for the acts of the company.
3) **Perpetual Existence** – A company enjoys the longest possible life. It is because, its life and living is not influenced by the events of death, insanity and insolvency of its members or owners. It has a separate legal entity where members may come or members may go, but the company goes on forever. As law creates it, it can be wound up only by law. Operation of law and its respect to law divides its life tenure. Unlike other forms we have seen, it enjoys pretty longer life.
4) **Separation of Ownership and Management** – In company from of organization, ownership and management are separated. It is simple that thousands of shareholders can not directly participate in management. Like a democratic form of government, the shareholders have a representation on the board of management. These representatives are called as the directors who are responsible for managing the

company business. This board or body is called as 'board of directors.' Thus, there is a divorse between ownership and management. Large membership and small value of share, makes it mandatory to have such an arrangement. No company carries an illegal business.

5) **Limited Liability** – Perhaps the most attractive feature of company form is the concept of limited liability. That is, shares of various types have a liability to the face or discounted or premium value extent and not beyond that strictly speaking a member is liable to pay only the unpaid part his shareholding. That is in case, the company is closed, he loses at the most what he has invested in company or committed to invest. His private property will not be attached.

SELECTION OF AN APPROPRIATE FORM OF BUSINESS OWNERSHIP

In a way, selecting one best form of business ownership is like looking for a shirt that may fit everybody in the family. The best form of ownership is one which helps in entrepreneur attain the business objectives decided upon by him/her while selecting the best form of business ownership, the entrepreneur should keep the following consideration in his/her mind.

1) **Nature of Business** – The selection of an appropriate form of business ownership depend upon to a great extent the nature of the proposed business itself. For eig the business that required personal attention and skill for their success are usually organized as proprietor concern. Business requiring pooling of funds and skill are run as partnership firms. For business involved in large scale production, the company form of business ownership is preferred.
2) **Area of Operations** – The area of operation has also an important bearing on the selection of the form of business ownership. If the operation of a business is confined to an area or locality only, the appropriate form of ownership will be proprietorship. On the contrary in case the area of operation is widespread catering to national and international market, the suitable form of business ownership may be company.
3) **Degree of Control** – In case, direct control over business operation is required, the suitable form of ownership may proprietorship or partnership. In case of direct control over the business. Operation is not needed, the best form of buss. ownership will be a company.
4) **Capital Requirements** – The capital required in the business also determines the selection of business ownership. If the business requires a small amount of capital, the best form of ownership may be either proprietorship or partnership. In case of huge capital requirement the company form of ownership will be the best.

5) Extent of Risk and Liability – Business involved risk. If an entrepreneur is ready and capable to bear risk involved in business, he can organized his business on proprietorship or partnership.

6) **Duration of Business** – If business is proposed for a definite duration and on adhoc basis proprietorship or partnership are better forms of business ownership. Because it is easy to form and dissolve. In case the business is to be run on permanent basis, it can be organized as a company or co-operative because it enjoy perpetual succession.

7) **Government Regulation** – In an entrepreneur does not like much government involvement in his/her business, he can select proprietorship or partnership as the form of his business ownership instead of a company or co-operative where government rules or co-operative where government rules and regulation apply more.