Unit – 1

Forms of Business: Sole Proprietorship

Learning Objectives

After completion of the unit, you should be able to:

- Explain the meaning, definition and characteristics of sole proprietorship.
- Describe the various benefits and limitations of forming a sole proprietorship business organization.
- Know the essentials of formation of a sole proprietorship business.
- Assess the suitability of the forms of various types of business organizations.
- Also understand the difference between sole proprietorship and partnership form of business.

Structure

1.1 Introduction

Business organizations are of various types. One of the most common and easy to form is Sole Proprietorship. The other forms include Partnership, Joint Stock Company, Joint Hindu Family and Cooperative Societies. This unit will explain you the intricacies of the establishment, working, risks and advantages associated with the most popular business form i.e. Sole Proprietorship.

1.2 Meaning of Sole Proprietorship

The term 'sole' means single and 'proprietorship' means 'ownership'. So, only one person is the owner of the business organization. This means, that a form of business organization in which a single individual owns and manages the business, takes the profits and bears the losses, is known as sole proprietorship form of business organization.

A sole proprietorship is a business owned by only one person. It is easy to set-up and is the least costly among all forms of ownership. The owner faces unlimited liability which means that the creditors of the business may go after the personal assets of the owner if the business cannot pay them.

The sole proprietorship form is usually adopted by small business entities. These firms are owned by one person, usually the individual who has day-to-day responsibility for running the business. Sole proprietorships own all the assets of the business and the profits generated by it. They also assume complete responsibility for any of its liabilities or debts. In the eyes of the law and the public, you are one in the same with the business.

With this type of business organization, you are the sole owner, and fully responsible for all debts and obligations related to your business.

1.3 Definition of Sole Proprietorship

According to J.L. Hanson, Sole Proprietorship is defined as:

"A type of business unit where one person is solely responsible for providing the capital and bearing the risk of the enterprise, and for the management of the business."

Thus, 'Sole Proprietorship' form of business organization refers to a business enterprise exclusively owned, managed and controlled by a single person with all authority, responsibility and risk.

1.4 Characteristics of Sole Proprietorship

The features of sole proprietorship are enlisted as below:

- **Single Ownership**: The sole proprietorship form of business organization has a single owner who himself/herself starts the business by bringing together all the resources.

- **No Separation of Ownership and Management**: The owner himself manages the business as per his own skill and intelligence. There is no separation of ownership and management as is the case with company form of business organization.
- **Less Legal Formalities**: The formation and operation of a sole proprietorship form of business organization does not involve any legal formalities. Thus, its formation is quite easy and simple.
- **No Separate Entity**: The business unit does not have an entity separate from the owner. The businessman and the business enterprise are one and the same, and the businessman is responsible for everything that happens in his business unit.
- **No Sharing of Profit and Loss**: The sole proprietor enjoys the profits alone. At the same time, the entire loss is also borne by him. No other person is there to share the profits and losses of the business. He alone bears the risks and reaps the profits.
- **Unlimited Liability**: The liability of the sole proprietor is unlimited. In case of loss, if his business assets are not enough to pay the business liabilities, his personal property can also be utilized to pay off the liabilities of the business.
- **One-man Control**: The controlling power of the sole proprietorship business always remains with the owner. He runs the business as per his own will.

1.5 Formation of Sole Proprietorship Business

It is very simple to establish a sole proprietary concern. Any person who is willing to start a business and has the necessary resources can set up this form of business organization. To start and operate the business in this form, practically does not require any legal formalities to be fulfilled. In some cases like restaurant, chemist shop etc. however, permission from the competent authority is required to be obtained before starting the business. Similarly, setting up a factory may involve taking permission from the local authority. But, formation of business unit as such does not involve any complexities.

1.6 Advantages of Sole Proprietorship

Sole proprietorship is a form of business organization which is very simple to initiate and can be run by a single person with small amount of money also. Thus, following are the significant benefits of sole proprietorship:

- **Easy to Form and Close:** It is very easy and simple to form a sole proprietorship form of business organization. No legal formalities are required to be observed. Similarly, the business can be wind up any time if the proprietor so decides. There are fewer forms to file than with other business organizations. The business is structured in such a manner that legal documents are not required to determine how profit-sharing from business operations will be allocated.
- **Quick Decision and Prompt Action**: Nobody interferes in the affairs of the sole proprietary organization. So the owner can take quick decisions on the

various issues relating to business and accordingly actions can be initiated at appropriate time.

- **Direct Motivation:** In sole proprietorship form of business organizations, the entire profit of the business goes to the owner. This motivates the proprietor to work hard and run the business efficiently to maximize his profits. Profits from the business flow-through directly to the owner's personal tax return.
- **Minimal working capital required for start-up**: The money required to meet the day to day expenses of the business is very less. The business can be started with a small amount of initial and working capital.
- **Flexibility in Operation**: It is very easy to effect changes as per the requirements of the business as decision making power lies with only one person. The expansion or curtailment of business activities does not require many formalities as in the case of other forms of business organization.
- **Maintenance of Business Secrets:** The business secrets are known only to the proprietor. He is not required to disclose any information to others unless and until he himself so decides. He is also not bound to publish his business accounts and share his investment and profit details.
- **Personal Touch:** Since the proprietor himself handles everything relating to business, it is easy to maintain a good personal contact with the customers and employees. By knowing the likes, dislikes and tastes of the customers, the proprietor can adjust his operations accordingly and can build personal goodwill. Similarly, as the employees are few and work directly under the proprietor, it helps in maintaining a harmonious and one to one relationship with them.
- **Least expensive form of ownership**: It is very easy and inexpensive to register the business under sole proprietorship. The process of its formation does not require any registration process and so it saves money at the initial establishment level. In case of partnership, a partnership deed is required and in case of a company, the full process of incorporation is mandatory which makes it expensive affair at the preliminary level only.
- **Regulatory burden is generally light**: There are less number of regulatory bodies who control the working of sole proprietorship. Thus, one can work in an autonomous manner without any interference of the regulatory bodies. In case of partnership, it is governed by Indian Partnership Act 1932 and a company form of business organization is governed by Companies Act, 2013. There is no specific act which governs the working of sole proprietorship.
- **Tax advantages if your business is not doing well**: The sole proprietorship business can lead to certain tax benefits in particular situations for example, deducting your losses from your personal income, and a lower tax bracket when profits are low. This is because the owner and the business are not treated as separate legal entity. Thus, business income becomes a part of the personal tax return filed by the sole proprietor.

1.7 Disadvantages of Sole Proprietorship

Despite of numerous advantages, sole proprietorship suffers from certain limitations due to which people opt for other forms of business organizations. The disadvantages of sole proprietorship are explained as follows:

- **Limited Resources:** The resources of a sole proprietor are always limited. Being the single owner it is not always possible to arrange sufficient funds from his own sources. Borrowing funds from friends and relatives or from banks can also be done but to a limited extent only. Further the sole proprietor can arrange funds from personal savings or consumer loans but again in a restricted manner only. So, the proprietor has a limited capacity to raise funds for his business.

- **Lack of Continuity:** The continuity of the business is linked with the life of the proprietor. Illness, death or insolvency of the proprietor can lead to closure of the business. Thus, the continuity of business is uncertain. If the legal representative of the deceased proprietor assumes the responsibility of the business, then also it is not necessary that he would be able to run the business with full competency as compared to the deceased proprietor.

- **Unlimited Liability:** In the sole proprietorship business organization, there is no separate entity of the business from its owner. In the eyes of law, the proprietor and the business are one and the same. If the business liabilities cannot be met out from the business assets, then personal properties of the owner can also be used to meet the business obligations and debts. Thus, sole proprietors have unlimited liability and are legally responsible for all debts against the business. Their business and personal assets are at risk.

- **Not Suitable for Large Scale Operations**: Since the resources and the managerial ability is limited, sole proprietorship form of business organization is not suitable for large-scale business. As the business grows in size, the financial requirements increases which cannot be met out from the pocket of the sole proprietor.

- **Limited Managerial Expertise**: A sole proprietorship form of business organization always suffers from lack of managerial expertise. A single person may not be an expert in all fields like purchasing, selling, financing, stock keeping etc. Again, because of limited financial resources, and the size of the business it is also not possible to engage the professional managers in sole proprietorship form of business organizations.

- **Lack of high-caliber employees:** In sole proprietorship, it is difficult to rope in those high caliber employees who are motivated by the opportunity to own a part of the business. Thus, attracting good talent becomes a constraint in this situation. In case of company, these employees can be easily attracted by offering them some of the shares in the company.

- **Deductions in Business Income:** Some employee benefits such as owner's medical insurance premiums are not directly deductible from business income of a sole proprietorship form of business organization. They are allowed only partially as an adjustment to income.

- **Taxable Income:** Income is taxable at the personal rate of an individual and, if the business is profitable, this could put the sole proprietor in a higher tax bracket.

1.8 Difference between Sole Proprietorship and Partnership

There are major differences in the business forms i.e. sole proprietorship and partnership. Some of them are mentioned as below:

Basis	Sole Proprietorship	Partnership
Meaning	A business form where only one person is the owner as well as the operator of the business is called Sole Proprietorship.	A business form in which two or more persons agree to carry on the business and share the profits and losses in the agreed ratio, is called Partnership.
Owner	Known as sole trader or sole proprietor.	Individually known as partners and collectively known as firm.
Incorporation	Not required	Voluntary
Governing Act	No specific statute	Indian Partnership Act, 1932
Liability	Borne by the proprietor only.	Shared by the partners.
Profit & Loss	Proprietor gets all profits and bear all losses.	Shared in agreed ratio.

1.9 Suitability

This structure is suitable if you are the business's sole owner and you do not need to distinguish the business from yourself. A sole proprietor can use his own name as the name of his business.

Sole proprietorships are not ideal and suitable for high-risk businesses because they put your personal assets at risk. If you are taking on significant amounts of debt to start your business, if you've gotten into trouble with personal debt in the past or if your business involves an activity for which you might potentially be sued, then you should choose a legal structure that will better protect your personal assets. Examples of risky businesses, include businesses that involve child care, animal care, manufacturing or selling edible goods, repairing items of value, and providing alcohol.

If the risks in your line of work are not very high, a good business insurance policy can provide protection and peace of mind while allowing you to remain a sole proprietor. One of the biggest advantages of a sole proprietorship is the ease with which business decisions can be made.

Following are some of the issues on the basis of which the suitability of the form of business organization will depend:

- **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 parlour 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.
- **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.

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.

1.10 Let's Sum Up

Sole proprietorship refers to a form of organization where business is owned, managed and controlled by a single individual who bears all the risks and is the only recipient of all the profits. The alternate name of this business form is sole trader ship. The person uses his capital, knowledge, skills and expertise to run a business solely. In addition to this, he has full control over the activities of the business. As this form of business is not a separate legal entity, therefore the business and its owner are inseparable. Merits of this form of organization include quick decision making, direct incentive, personal satisfaction, and ease of formation and closure. But this form of organization suffers from limitations of limited resources, unstable life span of business, unlimited liability of sole proprietor and his limited managerial ability.

1.11 Key Terms

Sole Proprietor: He is the one who owns, manages and controls a sole proprietorship business. He is also called a sole trader.

Unlimited Liability: It means if the business liabilities cannot be met out from the business assets, then personal properties of the owner can also be used to meet the business obligations and debts.

Working Capital: Working capital refers to the money required to meet the day to day expenses of the business.

1.12 Self-Assessment Questions

1. For which of the following types of business do you think a sole proprietorship form of organization would be more suitable, and why?
   (a) Gift Shop
   (b) Medical store
   (c) Law firm
   (d) Beauty Parlour
   (e) Cyber cafe
   (f) Chartered accountancy firm

2. Why is it important to choose an appropriate form of organization? Discuss the factors that determine the choice of form of organization.

1.13 Further Readings

- Isaac Greenblatt Kim, *Start Your Own Sole Proprietorship*, Kim Greenblatt Publishers.
- Sitarz Daniel, *Sole Proprietorship*, Nova Publishing Company.
- Jobs Manual, *Small Business: Helpful Ideas for Planning, Starting and Marketing a Small Business.*
- Kelbrat Tony, *Business Structure: From Sole Proprietorship to Going Public.*

1.14 Model Questions

1. What do you understand by a sole proprietorship firm? Explain its merits and limitation?
2. Despite limitations of size and resources, many people continue to prefer sole proprietorship over other forms of organization? Why?
3. 'Sole Proprietorship form of business organization is the best form for the business start-ups'. Explain.
4. Discuss the formation of a sole proprietorship business.
5. Differentiate between sole proprietorship and partnership.

Answers to Self-Assessment Questions

1. For

(a) Gift Shop,

(b) Medical store,

(d) Beauty Parlour,

(e) Cyber cafe

Sole proprietorship form of organization would be more suitable because of low capital required, less risk involved and quick decision making.

2. 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 organization are:

- **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 parlour 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.
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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.

Unit – 2
Forms of Business: Partnership

Learning Objectives

After completion of the unit, you should be able to:

- Explain the meaning and characteristics of partnership.
- Describe the procedure of registration of a partnership firm.
- Know about the types of partnerships and partners.
- Also understand the rights and duties of partners.
- Explain how partnership is different from Hindu Undivided Family and Company.
- Analyze the advantages and disadvantages of partnership.

Structure

2.1 Introduction

A partnership is a structure appropriate to use if you are not going to be the sole owner of your new business. Partnership is easy to start and can be dissolved as per the will of the partners. Admitting more partners and retiring of existing partners can be done in a convenient manner. The law governing partnership in India is now embodied in the Indian Partnership Act, 1932 which came into force on the 1st day of October 1932.

2.2 Meaning & Definition of Partnership

'Partnership' is an association of two or more persons who pool their financial and managerial resources and agree to carry on a business, and share its profit. The persons who form a partnership are individually known as partners and collectively a firm or partnership firm.

Partnership form of business organization in India is governed by the Indian Partnership Act, 1932 which defines partnership as "the relation between persons who have agreed to share the profits of the business carried on by all or any of them acting for all".

2.3 Characteristics of Partnership

An analysis of this definition reveals the following essential elements of partnership:

1. At least two persons- There must be at least two persons to form a partnership. All of them must be competent to contract. If at any time the number of partners in a firm gets reduced to one, then the firm is dissolved.

2. Maximum number of partners- The maximum limit on the number of persons is ten for banking business and 20 for other businesses. If the number exceeds the above limit, the partnership becomes illegal and the relationship among them cannot be called partnership.

3. Agreement- There must be a voluntary agreement between two or more persons to act as partners. Such persons must be competent to contract. Thus, minors, lunatics and insolvent persons are not eligible to become the partners. However, a minor can be admitted to the benefits of partnership firm i.e., he can have share in the profits without any obligation for losses.

4. Business- A partnership can be formed for the purpose of carrying on business. Where there is no business, there exists no partnership. The term "business must fulfil the following conditions:

(i) The business must be in existence at the time of formation of partnership. An agreement to carry on business in future cannot be the basis of partnership.

(ii) The business must be a running business. It must be carried on. Carrying on a business involves a series of transaction. Therefore, a single transaction of purchase and sale jointly by two or more persons does not mean business.

(iii) However, a permanent business undertaking is not essential for the formation of partnership. Even a single business undertaking or venture may form the basis of partnership.

(iv) The business must be lawful.

(v) The purpose of business must be to earn profits for private gain of its partners. Therefore, the clubs, societies etc. which aim at social service are not partnerships.

5. Sharing of profits- Sharing of profits of the partnership business among the partners is a must but sharing of losses by all the partners is not essential.

6. Mutual agency- To constitute a partnership, there must be a relation of mutual agency between the partners. Every partner while carrying on the business of the firm stands in a position of an agent as well as the principal. As an agent, he by his acts binds the firm, i.e. all the partners. As a principal, he is bound by the acts of other partners. Thus, every partner binds mutually to each other.

2.4 Formation of Partnership

Partnership arises from contract and not from status. Thus, a partnership can be formed by a contract between the persons. The contract of partnership may be express or implied.

Partnership Deed

When the contract of partnership is made in writing, it takes the form of a document. Thus, the document which contains the terms of contracts of partnership is called the partnership deed. It must contain all important terms of partnership agreed by the partners. It must be elaborate, clear and unambiguous about every aspect of the contract of partnership business. It must clearly lay-down rights and duties of partners. The deed must not contain any provision in contravention of the Indian Partnership Act. Moreover, terms must not be unlawful.

A partnership deed usually contains the provisions relating to the following:

1. Name of the firm.
2. Name of the partners.
3. Nature and place of business.
4. Date of commencement of partnership.
5. Duration of partnership.
6. Capital employed or to be employed by each partner.
7. Profit and loss sharing ratio.
8. Interest on capital.

9. Limit of drawings and interest on it.
10. Interest on loans by and to partners.
11. Salary or commission, if payable, to the partners.
12. Management and conduct of business.
13. Method of accounting and settlement of accounts in case of admission, retirement, death,

    expulsion etc. of a partner.
14. Rules as to admission, expulsion, and retirement etc. of a partner.
15. Settlement of accounts on dissolution of the firm.

The contents of a partnership deed may be altered according to the requirements of the firm. But any variation in the provisions of partnership deed must be made by the consent of all the partners of the firm. The deed must be duly signed by all the partners and duly stamped as required by the Indian Stamp Act. If the firm is a registered one, every deed and every alteration in the deed must be registered with the registrar of firms.

2.5 Registration of Partnership Firm

Registration of a firm means getting the partnership firm registered with the Registrar of Firms. A partnership may be registered with the Registrar of Firms of the area in which any place of business of the firm is situated or proposed to be situated. Such registrar is appointed by the State Government.

The registration of a firm is not compulsory. Under the Partnership Act, it is optional for the partners. An existing firm may be registered at any time even after the partners have agreed to dissolve the firm. But a firm must be a registered firm on the date of institution of a suit.

The procedure for registration of a partnership firm comprises the following steps:

1. Obtaining prescribed form: First of all, the partners intending to register a firm, must obtain a prescribed form for registration. It may be obtained from the office of the Registrar of Firms.

2. Preparing statement in the prescribed form: Thereafter, the partners must prepare a statement in the prescribed from. The statement contains the following information:

- The firm name. But the firm name shall not contain any of the following words, namely “Crown”, “Emperor”, “Queen”, “Royal”, or words expressing or implying the sanction, approval or patronage of Government, except when the State Government signifies its consent to the use of such words as part of the firm name by order in writing.
- The place of business of the firm and the names of any other places where the firm carries on business.
- The date when each partner joined the firm.

- The names in full and permanent addresses of the partners.
- The duration of the firm.

3. Signing the statement: The statement shall be signed by all the partners or by their agents specially authorized in this behalf.

4. Verifying the statement: Each person singing the statement shall also verify it in the manner prescribed.

5. Submit the statement with fee: When above required formalities have been complied with, the partners must submit the statement along with the prescribed fee for registration. The statement is to be submitted to the registrar of the area in which the place of business of the firm is situated or proposed to be situated.

6. Registration: When the Registrar is satisfied, it shall record an entry of the statement in a registrar called the Register of Firms and shall file the statement.

7. Issue of certificate of registration: Registrar after registration of the firm issues under his hand a 'Certificate of Registration'. The certificate must be signed by the Registrar himself and not by an Assistant Registrar.

Effects of Non-registration

Though the registration of firm is not compulsory but has become essential or desirable in view of the several adverse effects arising from non-registration. In other words the unregistered firm and its partners suffer from many disabilities. The effects of non-registration of firm are as under:

1. **No suit by a partner against the firm:** A partner of an unregistered firm cannot file a suit to enforce his rights arising from a contract against the firm.
2. **No suit by a partner against any other partners:** A partner of an unregistered firm cannot file a suit to enforce his rights arising from a contract or conferred by this Act against any other present or past partner in the firm.
3. **No suit by the firm against third party:** An unregistered firm cannot file a suit in any Court to enforce his any right arising from a contract against any third party.
4. **No suit by an unregistered partner against third party:** A partner of a registered firm whose name has not been shown in the register of firm as partner in the firm cannot sue to enforce his right arising from a contract against any third party.
5. **Third parties can sue against the firm and its partners:** Third parties can sue on any unregistered firm and its partners.

Exceptions:

Non-registration of firm does not affect the following rights:

- A partner of an unregistered firm can sue for dissolution of the firm.
- A partner can sue for the accounts of the dissolved firm.

- A partner can sue for realizing the property of a dissolved firm.
- An official assignee or receiver or court can realize the property of an insolvent partner.
- An unregistered firm can bring a suit to enforce its statutory rights. For instance, an unregistered firm can sue for protection of its rights under the Trade Marks Act, Patents Act, MRTP Act, etc.
- A third party can always sue against unregistered firm and the partners in the firm.
- A firm or any partner of the firm can sue for damages for misconduct against a partner.
- A money lender sharing profits of an unregistered firm can file a suit against the unregistered firm.

2.6 Types of Partnerships

Partnerships may be for a fixed term or without any duration, i.e. partnership at will. Sometimes partnerships are formed for completion of certain venture or undertaking, for instance, until the completion of a contract of construction of a bridge. The main types of partnerships are as under:

1. Partnership for a fixed term: When the duration of partnership is fixed by the partners by an agreement, it is said to be a partnership for a fixed term or period. Such partnership comes to an end on the expiry of that term. If all the partners wish to continue the business even after expiry of that term, the partnership becomes partnership at will.

2. Particular partnership: When a partnership is formed for a particular venture or undertaking it is called a particular partnership. Such partnership is limited to a particular venture or undertaking. Such partnership comes to an end on the completion of the venture.

3. Partnership at will: Where no provision is made by contract between the partners for the duration of their partnership or for determination of their partnership, the partnership is 'partnership at will'.

The main provisions regarding such a partnership are as under:

- It is a partnership for which no duration has been fixed.
- A fixed term partnership becomes partnership at will if the firm continues to carry on business after the expiry of that period.
- A particular partnership becomes partnership at will if it continues to carry out one or more ventures.
- Its existence depends on the will of partners.
- Where partnership is at a will, a partner may retire by giving a notice in writing to all the other partners of his intention to retire.

- Where partnership is at will, the firm may be dissolved by any partner by giving notice in writing of his intention to dissolve the firm to all the other partners.

2.7 Types of Partners

There are many types of partners having varying degrees of rights, duties and responsibilities. A few important types of partners are as under:

1. Actual or ostensible or active partner: Actual partner is one who becomes a partner in the firm by an agreement and who actively participates in the conduct of the business of the firm. An actual partner is actually an agent of the other partners of the firm. An actual partner is also a principal for all his copartners.

2. Sleeping or dormant partner: A sleeping or dormant partner means a partner who becomes a partner in the firm by agreement but never takes active part in the conduct of the business of the firm.

3. Nominal partner: A nominal partner is one who lends his name to the firm without having any pecuniary interest in the business of the firm. Neither he invests money in the firm nor does he share the profits of the business of the firm. But, he is liable like an actual partner of the firm to the third parties for all the debts of the firm.

A nominal partner is different from a sleeping partner in the following respects:

- A nominal partner is known to the outsiders as a partner of the firm but he is not a partner at all. On the other hand, a sleeping partner is a real partner of the firm but outsiders do not know this fact.
- A nominal partner does not share in the profits of the firm but a sleeping partner gets a share in the profits.

But both are liable to the third parties for all the debts of the firm.

4. Partner in profits only: In a partnership, sharing of profits of the business of the firm is a must but sharing of losses is not essential by all the partners. Therefore, a partner who agrees to share in the profits of the firm only and does not agree to be liable for the losses of the firm is a partner in profits only.

5. Sub-partner- A sub-partner is not a partner in the firm but a partner of a partner in the firm. Thus, a sub-partner is the person who gets a share in the profits derived by the partner from the firm. A sub partner is not directly connected with the firm and does not have mutual agency with any partner of the firm.

6. Partner by estoppel or holding out- Sometimes, a person by his words or conduct creates or permits others to create an impression in the mind of a third party that he is a partner of the firm though he is not. If the third party on the faith of such impression gives credit to the firm, the person creating or permitting to create such impression shall be called a partner by estoppel or holding out.

A retiring partner also becomes a partner by holding out if he does not give public notice of his retirement and the continuing partners use his name as partner. The retired partner remains liable by holding out to those parties dealing with the firm who gave credit without knowledge of his retirement.

Rights of Partners

Where there is no contract between the partners to the contrary, every partner has the following rights:

1. Right to take part in business: Subject to contract between the partners, every partner has a right to take part in the conduct of the business. This is because partnership business is a business of all the partners and their powers to conduct and manage the business in co-extensive.

2. Right to be consulted: Subject to contract between the partners, every partner has a right to be consulted on all important matters connected with the business of the firm. Every partner has a right to express his opinion before the matter is decided.

3. Right of access to books: Every partner has a right to have access to the books of the firm. He can exercise this right either personally or through his agent. This right, however, must be exercised bonafide.

4. **Right to remuneration:** Generally, a partner is not entitled to receive remuneration for taking part in the conduct in the business. A partner is entitled to remuneration even without express contract if it is paid as per the custom of the trade.

5. Right to share profits: Subject to contract between the partners, every partner is entitled to share equally in the profits earned, and is liable to contribute equally to the losses sustained by the firm.

6. Right to interest on capital: If the partnership deed provide for payment of interest on capital, the partners are entitled to the interest. However, the interest on capital shall be payable only out of profits.

7. Right to interest on advances: Sometimes, a partner makes an advance to the firm beyond the amount of capital. In such a case, the partner is entitled to interest thereon at the rate of six per cent per annum. Such interest can even be paid out of the capital of the firm.

8. Right in emergency: A partner has authority, in an emergency; to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances. The firm will be bound by his such acts.

9. Right to be indemnified: Every partner has a right to be indemnified by the firm in respect of the payment made or liability incurred by him in the ordinary conduct of the business or in doing any act in emergency for the purpose of protecting the firm from loss.

10. Right as an agent of the firm: A partner is the agent of the firm for the purpose of the business of the firm. Therefore, when a partner acts to carry on the usual business of firm, he binds the firm just as an agent binds his principal. Thus, he has all the rights of an agent.

11. Right to prevent admission of a new partner: Every partner has a right to prevent the admission of a new partner in the firm without consent of all the partners including his own consent.

12. Right to retire: A partner has a right to retire with the consent of all the other partners or in accordance with the agreement by the partners.

13. Right of outgoing partner to carry on competing business: An outgoing partner may carry on a business competing with that of the firm and he may advertise such business, but without-

(a) Using the firm name,

(b) Representing himself as carrying on the business of the firm, or

(c) Soliciting the custom of persons who were dealing with the firm before he ceased to be a partner.

14. Right of outgoing partner to share subsequent profits: Every outgoing partner or representative of a deceased partner has a right to claim either a share in the subsequent profits of the firm or interest at the rate of 6 per cent per annum on the amount of his share in the property of firm till the accounts are finally settled. This right is subject to the terms of the contract.

15. Right to dissolve the firm: Where the partnership is at will, the firm may be dissolved by any partner. For this, the partner is required to give notice in writing to all the other partners of his intension to dissolve the firm.

2.9 Duties of Partners

Partnership is the relation founded on the principle of good faith. It is primarily based on mutual trust and confidence. Most of the duties of partners emerge from this fundamental principle. Some of the duties of partners are as under:

1. To carry on business to the greatest common advantage
2. To be just and faithful
3. To render true accounts
4. To give full information
5. To indemnify for fraud
6. Not to claim remuneration
7. Duty to share losses
8. To use property for the business of the firm
9. To account for private profits

10. To account for profits of a competing business
11. To act within authority
12. To be liable for the acts of the firm

2.10 Difference between Partnership & Hindu Undivided Family

Basis	**Partnership**	**Hindu Undivided Family**
Creation	Partnership is created by contract.	It is created by operation of law or by status.
Governing Law	It is governed by the Indian Partnership Act, 1932.	It's governed by Hindu Law.
Names of Members	The members of the firm are called partners.	The members of JHF are known as co-partners.
Limit on Membership	There is a limit on maximum number of members. It is ten or twenty as the case may be.	There is no limit on maximum number of members.
Admission of members	A new member may be admitted by the consent of all the exiting partners.	A male becomes a member of JHF by birth or by adoption in the family.
Minor member	A minor cannot be a partner in a firm but can be admitted to the benefits of the firm.	A male minor becomes a member of JHF merely by birth.

Female member	A female can be a partner in a firm.	A female does not become member by birth in the family.
Head	No one is head of the firm automatically.	The '*Karta*' of JHF is the automatic head of the JHF firm.
Liability	The liability of each partner is unlimited. Personal estate of a partner is liable for firm's debts.	In JHF firm, the *Karta* is personally liable for the debts. The members are not personally liable. They are liable only to the extent of their interest in the business unless they are also parties to the contract.
Rights of members	In partnership, every partner has a right to inspect and have a copy of account books of the firm and ask the account of profits and losses.	No member of JHF can ask the '*Karta*' for accounts of the past dealings, and profits and losses of the firm.
Registration	Registration of partnership firm is optional.	There is no provision for JHF firm as such.
Effect of member's death	In the absence of a contract to the contrary, the partnership is dissolved on the death of any	The death of any member has no effect on the existence of JHF business.

	partner.	

2.11 Difference between Partnership and Company

The main points of difference between partnership and a joint stock company are as under:

Basis of Distinction	**Partnership**	**Joint Stock Company**
Meaning	A partnership is a relation between persons who have agreed to share profits of a business carried on by all or any of them acting for all.	A Joint Stock Company is an artificial person created by law having perpetual succession and a common seal.
Creation	It is created by a contract between two or more persons.	It is created by following a procedure laid down by the law.
Registration	Registration of partnership firm is not compulsory.	Registration of a company is compulsory.
Separate existence	Partnership firm has no separate legal existence.	A Company has a separate legal existence apart from the members forming it.
Liability	Liability of partners is unlimited. Their personal estate is liable for the debts of the firm.	Liability of every member of a company is limited to the extent of face value of shares held by him or guarantee given by him.
Rights on	The property of the	The property of

the property	firm is the joint property of all the partners. All the partners can divide the property among them.	the company is the property of the company. Therefore, all the members of the company cannot divide it among themselves.
Management	A partnership is managed by all or any one of the partner on behalf of all.	A company is managed by the board of directors elected by the members of the company.
Perpetual succession	A partnership has no perpetual succession. A partnership is automatically dissolved on death or insolvency of any partner.	A company has perpetual succession. Death or insolvency of a member does not have effect on the existence of a company.
Contractual capacity	A partner cannot enter into contract with the firm as such but can contract with other partners.	A member of a company can contract with the company as well as with other members of the company.
Statutory obligations	A partnership has only a few statutory obligations.	A company has so many statutory obligations regarding formation, management ,meetings, audit etc.

2.12 Advantages of Partnership

There are numerous merits of Partnership form of business organization. Some of them are illustrated as below:

1. **Easy to Form:** A partnership can be formed easily without many legal formalities. Since it is not compulsory to get the firm registered, a simple agreement, either in oral, writing or implied is sufficient to create a partnership firm.
2. **Availability of Larger Resources:** Since two or more partners join hands to start partnership firm it may be possible to pool more resources as compared to sole proprietorship form of business organization.
3. **Balanced Decisions:** In partnership firm each partner has a right to take part in the management of the business. All major decisions are taken in consultation with and consent of all partners. Thus, collective wisdom prevails and there is less scope for hasty decisions.
4. **Flexibility:** The partnership firm is a flexible organization. At any time the partners can decide to change the size or nature of business or area of its operation after taking the necessary consent of all the partners.
5. **Sharing of Risks:** The losses of the firm are shared by all the partners equally or as per the agreed ratio.
6. **Keen Interest:** Since partners share the profit and bear the losses, they take keen interest in the affairs of the business.
7. **Benefits of Specialization:** All partners actively participate in the business as per their specialization and knowledge. For example in a partnership firm providing legal consultancy - one partner may deal with civil cases, one in criminal cases, another in labour cases and so on as per their area of specialization.
8. **Protection of Interest:** In partnership form of business organization, the rights of each partner and his interests are fully protected. If a partner is dissatisfied with any decision, he can ask for dissolution of the firm or can withdraw from the partnership.
9. **Secrecy:** Business secrets of the firm are only known to the partners. It is not required to disclose any information to the outsiders. It is also not mandatory to publish the annual accounts of the firm.

2.13 Disadvantages of Partnership

Despite of many advantages, there still exist certain disadvantages of partnership. Some of them are as follows:

1. **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.
2. **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.
3. **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.

4. **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. However, in normal circumstances also partnership business tends to have conflicts after a certain time period due difference in opinions.
5. **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.
6. **Sharing of profits:** More the number of partners, higher is the amount of profit which has to be shared. The partners may be demotivated if they think their contribution in the business is more than his share in the profits.

2.14 Dissolution of Partnership and Partnership Firm

The dissolution of partnership between all partners is called the "dissolution of the firm".

Dissolution of partnership takes place where any change in the relations between the partners or change in the composition of firm occurs and the business is continued in firm's name under altered circumstances. In other words, dissolution of partnership takes place where a firm is reconstituted.

The difference between the two concepts is explained as below:

Basis	**Dissolution of partnership**	**Dissolution of partnership firm**
Relation between partners	In case of dissolution of partnership, the relation between partners of the firm change.	In case of dissolution of firm, the relations between all the partners come to an end.
Change in partners	There may or may not be a change in the partner. New partners may be introduced.	All the partners cease to be in a position of partners. They are no more mutual agents.
Continuation of business	The business is continued in the same firm's name.	The business is discontinued in the firm's name.
Revaluation or realization of assets	In this case, the firm's assets are revalued in order to determine the share of the each partner at the time of reconstitution.	In this case, the firm's assets are realised to pay off debts and distribute surplus.
Reconstitution	Dissolution of partnership	Dissolution of firm

and winding up	results in reconstitution of the firm.	results winding up of the firm.

Modes of Dissolution of Firm

Modes of dissolution of a firm may be classified into two heads:

I. Modes without the order of the Court or voluntary modes

II. Mode by order of the Court

I. Without the order of the Court:

Dissolution without the order of the court or voluntary dissolution may take place in any one of the following ways:

1. Dissolution by agreement.

2. Compulsory dissolution.

3. Dissolution on happening of certain contingencies.

4. Dissolution by notice.

1. Dissolution by agreement- A firm may be dissolved by agreement in the following ways:

(a) With the consent of all the partners

(b) In accordance with a contract between partners

2. Compulsory dissolution- A firm is compulsorily dissolved in the following circumstances:

(a) By insolvency of all or one partner

(b) By business becoming unlawful

3. Dissolution by happening of contingencies- Subject to contract between the partners, a firm is dissolved by happening of any of the following contingencies:

(a) Expiry of the term

(b) Completion of the venture

(c) Death of a partner

(d) Insolvency of a partner

4. Dissolution by notice- Where the partnership is at will, the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm.

II. Dissolution by Court: A firm may be dissolved by the order of the Court on the following grounds:

1. Insanity- When a partner has become of unsound mind, a suit may be filed for dissolution of the firm.

2. Permanent incapacity- When a partner has become in any way permanently incapable of performing his duties as partner, a suit may be filed before the Court for dissolution of the firm. Incapacity of a partner must be permanent. It may be physical or mental.

3. Misconduct- When a partner is guilty of conduct or misconduct, the Court may dissolve the firm. Such suit may be filed by a partner other than the guilty partner. Misconduct need not be directly connected with the business of the firm. It may be of any kind which may affect prejudicially the business of the firm. Following acts have been held to be misconduct of a partner:

- Guilty for breach of trust by a partner.
- Gambling or speculation by a partner.
- Persistent neglect or refusal by a partner to participate in the conduct of business of the firm.
- Embezzlement of funds of clients received on behalf of the firm.
- Theft of firm's account books.

4. Persistent breach of agreement- The Court may also dissolve a firm when a suit is filed against a partner for willful or persistent breach of agreement.

5. Transfer of interest- The Court may order for dissolution of the firm when a partner has transferred his interest in any of the following ways:

- When a partner has transferred whole of his interest in the firm to a third party.
- When he has allowed it to be sold in the recovery of land revenue.

6. Perpetual losses- When the business of the firm cannot be carried on except at a loss the Court may dissolve the firm on an application by any partner. This is because of the fact that a partnership firm is established with an object of earning and sharing profits between the partners. If the very object is defeated, there is no reason for existence of a firm.

7. Any other just and equitable ground- When any partner makes an application for dissolution of the firm on any other ground and the court thinks it just and equitable that the firm should be dissolved. The Courts may granted dissolution of the firm in the following cases:

- When partners refuse to meet on matters of business.
- When the partners continue to quarrel and do not have speaking terms.
- When a dead-lock is created in the management of affairs of the firm.

2.15 Let's Sum Up

Partnership is defined as an association of two or more persons who agree to carry on a business together and share the profits as well as bear risks collectively. Major advantages of partnership are: ease of formation and closure, benefits of specialization, greater funds, and reduction of risk. Major limitations of partnership are unlimited liability, possibility of conflicts, lack of continuity and lack of public confidence. As there are different types of partners such as active, sleeping, secret and nominal partners, so is the case with types of partnerships which can vary from general partnership, limited partnership, and partnership at will to particular partnership. Partnership is suitable when more funds are required and more than one person is required to manage the affairs of the business.

2.16 Key Terms

Partnership: It is an association of two or more persons who pool their financial and managerial resources and agree to carry on a business, and share its profit.

Hindu Undivided Family: It is a form of business organization which is created by operation of law or by status of a Hindu Undivided Family. The head of the family is called Karta and he does all the contracts on behalf of the whole family. The male members automatically become its members by birth.

Partnership Deed: The document which contains the terms of contracts of partnership is called the partnership deed. It is in writing and stamped appropriately.

Dissolution of partnership: It takes place where any change in the relations between the partners or change in the composition of firm occurs and the business is continued in firm’s name under altered circumstances.

2.17 Self-Assessment Questions

1. For which of the following types of business do you think a partnership form of organization would be more suitable, and why?
   a. Medical store
   b. Legal consultancy
   c. Internet café
   d. Chartered accountancy firm
2. If registration is optional, why do partnership firms willingly go through this legal formality and get themselves registered? Explain.
3. What is meant by 'partner by estoppel'? Explain.

2.18 Further Readings

- K. R. Bulchandani, *Business Law*, Himalaya Publishing house.
- Subramanian P. L., *Practical Guide to Limited Liability Partnership,* Snow White Publications Pvt. Ltd.
- Kannan Justice K., *Mulla: The Sale of Goods Act and Indian Partnership Act,* Lexis Nexis India Publishers.

2.19 Model Questions

1. Why is partnership considered by some to be a relatively unpopular form of business ownership? Explain the merits and limitations of partnership.
2. Differentiate between Partnership and Joint Hindu Family form of business organization.
3. What do you understand by dissolution of partnership? How is it different from dissolution of partnership firm?
4. Discuss the process of registration of a partnership firm.
5. What is Partnership Deed? Illustrate the contents of the partnership deed.

Answers to Self-Assessment Questions

1. For (b) Legal consultancy and (d) Chartered accountancy firm - partnership form of organization would be more suitable because of high managerial ability and comparatively wide range of operations.

2. 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 stated as follows:

a. 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.

b. 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.

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

3. A person is considered a partner by estoppel if, through his own initiative, conduct or behavior, he gives an impression to others that he 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.

Unit – 3

Forms of Business: Company

Learning Objectives

After completion of the unit, you should be able to:

- Explain the meaning and characteristics of a company.
- Describe the various advantages and limitations of a company.
- Know about the types of companies.
- Understand the process of formation of a company.

Structure

3.1 Introduction

Company is an association of persons formed for carrying out business activities and has a legal status independent of its members. The company form of organisation is governed by The Companies Act, 2013. The shareholders are the owners of the company while the Board of Directors is the chief managing body elected by the shareholders. Usually, the owners exercise an indirect control over the business.

3.2 Meaning & Definition of Company

Company is a voluntary association of persons formed & registered under Companies Act, 2013.

Company is an artificial person having separate entity from its members, with perpetual succession & a common seal. The capital of the company is divided into transferable shares & the shareholders are called members.

Joint Stock Company is a voluntary association of individuals for profit, having a capital divided into transferable shares, the ownership of which is the condition of membership.
Prof. Haney

3.3 Characteristics of Company

The definition of a joint stock company highlights the following features of a company.

1. **Registered Voluntary Association:** It comes into existence after registration i.e. it becomes a body corporate by the name with which it is registered.
2. **Artificial person:** A company is a creation of law and exists independent of its members. Like natural persons, a company can own property, incur debts, borrow money, enter into contracts, sue and be sued but unlike them it cannot breathe, eat, run or talk. It is, therefore, called an artificial person.
3. **Separate legal entity:** From the day of its incorporation, a company acquires an identity, distinct from its members. Its assets and liabilities are separate from those of its owners. The law does not recognize the business and owners to be one and the same.
4. **Formation:** The formation of a company is a time consuming, expensive and complicated process. It involves the preparation of several documents and compliance with several legal requirements before it can start functioning. Registration of a company is compulsory as provided under the Indian Companies Act, 2013.
5. **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. It never dies. It continuously exists & is not affected by lunacy, retirement, death or insolvency of its members.

6. **Control:** The management and control of the affairs of the company is undertaken by the Board of Directors, which appoints the top management officials for running the business. The directors hold a position of immense significance as they are directly accountable to the shareholders for the working of the company. The shareholders, however, do not have the right to be involved in the day-to-day running of the business.
7. **Liability:** The liability of the members is limited to the extent of the capital contributed by them in a company. The creditors can use only the assets of the company to settle their claims since it is the company and not the members that owes the debt. The members can be asked to contribute to the loss only to the extent of the unpaid amount of share held by them. In a company limited by guarantee, the liability of member is limited to the amount guaranteed by him.
8. **Common seal:** The Company being an artificial person acts through its Board of Directors. The Board of Directors enters into an agreement with others by indicating the company's approval through a common seal. The common seal is the engraved equivalent of an official signature. Any agreement which does not have the company seal put on it is not legally binding on the company.
9. **Risk bearing:** The risk of losses in a company is borne by all the shareholders. This is unlike the case of sole proprietorship or partnership firm where one or few persons respectively bear the losses. In the face of financial difficulties, all shareholders in a company have to contribute to the debts to the extent of their shares in the company's capital. The risk of loss thus gets spread over a large number of shareholders.
10. **Members/subscribers:** Minimum 7 persons in case of public company & 2 in case of private company are required. Persons, who agree to form a company, have to sign the memorandum of the company & these signatories are called subscribers to the memorandum. On registration they are called first members of the company. Maximum members in private company may be 200 & there is no limit in public company.
11. **Residence:** For communication purposes, the residence of the company is the place of its registered office. For purpose of Income Tax Act, a company resides where its real business is carried on.

Forms of Business: Company

3.4 Advantages of a Company

The company form of organisation offers a multitude of advantages, some of which are explained as follows:

1. **Limited liability:** The shareholders are liable to the extent of the amount unpaid on the shares held by them. Also, only the assets of the company can be used to settle the debts, leaving the owner's personal property free from any charge. This reduces the degree of risk borne by an investor. In case of guarantee also, the liability is limited to the amount guaranteed.
2. **Transfer of interest:** The ease of transfer of ownership adds to the advantage of investing in a company as the share of a public limited company can be sold

in the market and as such can be easily converted into cash in case the need arises. This avoids blockage of investment and presents the company as a favourable avenue for investment purposes. Online trading of securities makes it easy and comfortable to sale and purchase the shares.

3. **Perpetual existence:** Existence of a company is not affected by the death, retirement, resignation, insolvency or insanity of its members as it has a separate entity from its members. It can be liquidated only as per the provisions of the Companies Act. The company will exist irrespective of the ownership held by its members in the form of shares.
4. **Scope for expansion:** As compared to the sole proprietorship and partnership forms of organization, a company has large financial resources. Further, capital can be attracted from the public as well as through loans from banks and financial institutions. Thus there is greater scope for expansion. The investors are inclined to invest in shares because of the limited liability, transferable ownership and possibility of high returns in a company.
5. **Professional management:** A company can afford to pay higher salaries to specialists and professionals. It can, therefore, employ people who are experts in their area of specializations. It can also attract those employees who get motivated by getting share in the company, which is not possible in case of sole proprietorship and partnership.

3.5 Limitations of a Company

The major limitations of a company form of organisation are explained as below:

1. **Complexity in formation:** The formation of a company requires greater time, effort and extensive knowledge of legal requirements and the procedures involved. As compared to sole proprietorship and partnership form of organisations, formation of a company is more complex. The incorporation of a company requires the preparation of a number of documents along with specific legal compliances associated with each.
2. **Lack of secrecy:** The Companies Act requires each public company to provide from time-to-time a lot of information to the office of the registrar of companies. Such information is available to the general public also. It is, therefore, difficult to maintain complete secrecy about the operations of company. Although, the company is fully autonomous body which can function independently.
3. **Impersonal work environment:** Separation of ownership and management leads to situations in which there is lack of effort as well as personal involvement on the part of the officers of a company. The large size of a company further makes it difficult for the owners and top management to maintain personal contact with the employees, customers and creditors.
4. **Numerous regulations:** The functioning of a company is subject to many legal provisions and compulsions. A company is burdened with numerous restrictions in respect of aspects including audit, voting, filing of reports and preparation of documents, and is required to obtain various certificates from

different agencies, viz., registrar, SEBI, etc. This reduces the freedom of operations of a company and takes away a lot of time, effort and money.

5. **Delay in decision making:** Companies are managed through the Board of Directors which is followed by the top management, middle management and lower level management. Decision making is done by the rule of majority in the board meeting. Several decisions remain pending due to lack of majority or lack of required quorum at the board meeting.
6. **Conflict in interests:** There may be conflict of interest amongst various stakeholders of a company. The employees, for example, may be interested in higher salaries, consumers desire higher quality products at lower prices, and the shareholders want higher returns in the form of dividends and increase in the intrinsic value of their shares. These demands pose problems in managing the company as it often becomes difficult to satisfy such diverse interests.

3.6 Types of Companies

There are different types of companies which can be formulated under Companies Act, 2013. The companies are explained as below:

1. Private Company
2. Public Company
3. One Person Company
4. Dormant Company
5. Holding and Subsidiary Company

Private Company: A private company means a company which:

- restricts the right of members to transfer its shares;
- has a minimum of 2 and a maximum of 200 members;
- does not invite public to subscribe to its share capital; and
- must have a minimum paid up capital of Rs.1 lakh or such higher amount which may be prescribed from time-to-time.

It is necessary for a private company to use the word private limited after its name. If a private company contravenes any of the aforesaid provisions, it ceases to be a private company and loses all the exemptions and privileges to which it is entitled. The following are some of the privileges of a private limited company as against a public limited company:

1. A private company can be formed by only two members whereas seven people are needed to form a public company.
2. There is no need to issue a prospectus as public is not invited to subscribe to the shares of a private company.
3. 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.
4. A private company needs to have only two directors as against the minimum of three directors in the case of a public company.

5. A private company is not required to keep an index of members while the same is necessary in the case of a public company.
6. 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.

Public Company: A public company means a company which is not a private company. As per the Indian Companies Act, a public company is one which:

- has a minimum paid-up capital of Rs. 5 lakhs or a higher amount which may be prescribed from time-to-time;
- has a minimum of 7 members and no limit on maximum members;
- has no restriction on transfer of shares; and
- is not prohibited from inviting the public to subscribe to its share capital or public deposits.

A private company which is a subsidiary of a public company is also treated as a public company.

One Person Company: It is a company which has only one member. Only a natural person who is a citizen of India and a resident in India shall be eligible to incorporate one person company or be appointed as a nominee for the sole member of one person company. One person company is a private company - may be limited by shares, have share capital or limited by guarantee.

Dormant Company: Where a company is registered for a future project or to hold an asset or an intellectual property and has no significant accounting transactions, such an inactive company can make an application to the registrar of the companies for obtaining the status of dormant company.

Holding and Subsidiary Company: In relation to one or more other companies, a holding company means a company of which such companies are subsidiary companies.

A subsidiary company means a company in which the holding company either controls the composition of the board of directors or exercises or controls more than one half of the total share capital either on its own or with one or more of its subsidiary company.

3.7 Formation of a Company

When the formation of a company comes into existence it is known as its incorporation. Usually the first step to form a company is the process known as 'promotion' where a person persuades others to contribute capital to a proposed company before it is incorporated. Such a person is called the promoter of the company. An application is to be made to the Registrar of the companies with the required documents. The important documents include:

- Memorandum of Association
- Articles of Association
- Prospectus
- Other related documents

The detailed procedure is explained in the Block 4.

3.8 Let's Sum Up

A company may be defined as an artificial person, existing only in the eyes of the law with perpetual succession, having a separate legal identity and a common seal. A company is considered by law to be a unique entity, separate and apart from those who own it. A Corporation can be taxed; it can be sued; it can enter into contractual agreements. The owners of a corporation are its shareholders. The shareholders elect a board of directors to oversee the major policies and decisions. The corporation has a life of its own and does not dissolve when ownership changes. While major advantages of a company form of organization are members' limited liability, transfer of interest, stable existence, scope for expansion, and professional management; its key limitations are: complexity in formation, lack of secrecy, impersonal work environment, numerous regulations, delay in decision making and conflict of interests among different shareholders.

Companies can be of five types — private company, public company, one man company, dormant company, holding and subsidiary company. The most popular company forms are public and private company. A private company is one which restricts transfer of shares and does not invite the public to subscribe to its shares. A public company, on the other hand, is allowed to raise its funds by inviting the public to subscribe to its share capital. Furthermore, there is a free transferability of shares in the case of a public company.

3.9 Key Terms

Company: Company is an artificial person having separate entity from its members, with perpetual succession & a common seal. The capital of the company is divided into transferable shares & the shareholders are called members.

Public Company: It is a company which is not a private company.

Private Company: A private company means a company which restricts the right of members to transfer its shares; has a minimum of 2 and a maximum of 200 members; does not invite public to subscribe to its share capital; and must have a minimum paid up capital of Rs.1 lakh or such higher amount which may be prescribed from time-to-time.

Dormant Company: Where a company is registered for a future project or to hold an asset or an intellectual property and has no significant accounting transactions, such an inactive company can make an application to the registrar of the companies for obtaining the status of dormant company.

Holding Company: It is a company which controls the subsidiary company.

Subsidiary Company: It is a company in which the holding company either controls the composition of the board of directors or controls more than one half of the total share capital.

3.10 Self-Assessment Questions

1. Explain the following terms in brief:
(a) Perpetual succession
(b) Common seal
(c) Artificial person

2. Differentiate between public company and private company.

3. Discuss which form of the business organization will be most advantageous and most disadvantageous if the following factors are given priority in choosing the form of business organization:

a) Availability of Capital
b) Ease of Formation
c) Transfer of Ownership
d) Managerial Skills
e) Regulations
f) Flexibility
g) Continuity
h) Liability

3.11 Further Readings

- Prasad G., *Business and Corporate Laws*, Jai Bharath Publishers.
- Kapoor G.K., *Corporate Laws*, Taxmann Publications.
- The Institute of Company Secretaries of India, *A Comparative Study of Companies Act 2013 and Companies Act 1956*, Taxmann Publications.
- Gulshan S.S. & Kapoor G.K., *Business Law Including Company Law*, New Age International.

3.12 Model Questions

1. What do you understand by a company? Outline the features of a company.
2. ‘Company form of organization is more advantageous than sole proprietorship and partnership’. Explain.
3. Discuss the limitations of a company.
4. What is a government company? How is it formulated?
5. Explain the various types of companies as specified in the Companies Act, 2013.

Forms of Business: Company

Answers to Self-Assessment Questions

1. (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) 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 and so on. It is, therefore, called an artificial person.

2. The difference between private and public company is expressed as below:

Basis	**Public Company**	**Private Company**
Members	Minimum: 7 Maximum: Unlimited	Minimum: 2 Maximum: 200
Minimum number of Directors	Three	Two
Minimum paid up capital	Rs. 5 lakh	Rs. 1 lakh
Invitation to public to subscribe to shares	Can invite the public to subscribe to its shares.	Cannot invite public to subscribe to its shares.
Transfer of shares	The shares are freely transferable.	There is a restriction on the transfer of

		shares.
Index of members	Compulsory	Not Compulsory

3. The following table depicts the most advantageous and most disadvantageous form of business organization:

Factor	**Most Advantageous**	**Most Disadvantageous**
Availability of Capital	Company	Sole Proprietorship
Ease of Formation	Sole Proprietorship	Company
Transfer of Ownership	Company	Partnership
Managerial Skills	Company	Sole Proprietorship
Regulations	Sole Proprietorship	Company
Flexibility	Sole Proprietorship	Company
Continuity	Company	Sole Proprietorship
Liability	Company	Sole Proprietorship