Forms of Business organization

One of the first decisions that you'll have to make as a business owner is how your business should be structured. You need to know the advantages and disadvantages of each of the different forms of business organization to make sure you're making the right decision for your new business.

All businesses must adopt some legal configuration that defines the rights and liabilities of participants in the business's ownership, control, personal liability, lifespan and financial structure. The form of business determines which income tax return form to file and the company's and owners' legal liabilities.

When you're forming your new business, you will want to take into account the following:

- Your (practical) vision regarding the size and nature of your business.
- The level of control you wish to have.
- The level of "structure" you are willing to deal with.
- The business's vulnerability to lawsuits.
- Tax implications of the different organizational structures.
- Expected profit (or loss) of the business.

Sole proprietorship

The vast majority of small businesses start out as sole proprietorships. These businesses are owned by one person, usually, the individual who has day-to-day responsibility for running the business. Sole proprietors can be independent contractors, freelancers or home-based businesses.

Features of a Sole Proprietorship

- **Formation of Business and Closure**

Such business organisations are formed by a sole proprietor at his discretion. Similarly, the owner has the right and the legal authority to determine when he will close the business. If, for example, the owner feels his fully-owned entity is facing a fiscal crunch, he may decide to shut shop. Since there are no hard and fast rules that govern sole proprietorship in India, there is no legal obligation for him to change his mind.

- **Liability**

In any sole proprietorship, the owner has "unlimited liability". If he avails a business loan from a financial establishment, he will be liable to repay it. If he is unable to settle up on time, his private estates may be put on sale by the lender. The sole owner is liable to repay anyone who has helped him financially for his business purposes. This concept of unlimited liability is one of the significant disadvantages of a sole proprietorship. However, it remains a crucial characteristic of such ventures.

- **Risk Bearing and Profit-sharing**

The sole owner is the only individual who nears any business risks associated with his venture. No one else will bear any portion of that risk.

Conversely, the owner is also eligible to enjoy all the profits which his business delivers. If there are any losses, he will have to deal with them on his own.

- **Sole Control**

Because the owner controls a business, he alone controls all the rights and responsibilities. It is his prerogative to change the course of his business or to exit a particular sector altogether. It is one of the many characteristics of sole proprietorship and wholly-owned businesses. The owner's judgements even if error-ridden, are final and no one else can interfere in them if not otherwise solicited.

If a business' operations and methods of functioning are to be modified, only the owner can do so. No one else is authorised.

- **No separate Entity**

Unlike other types of business ventures, a sole proprietor and his business are the same entity. According to the existing laws, since the sole owner operates a business, he is the entity. In case the owner expires, the business wraps up automatically. However, if the business has been passed down to successors, the clauses are different. The continuity of business clause then kicks in. The same concept also takes precedence when the proprietor is taken ill, imprisoned or otherwise aggravated.

Advantages of a Sole Proprietorship

There are several advantages. The most basic ones are enumerated here

- **Prompt decision-Making Process:**

  Since these are necessarily a one-man show, there are minimal hassles when a perticular particular decision has to be reached at. The proprietor does not need anyone's permission or consent, or dissent, to carry on exactly as he wills. This lack of such agility in decision-making in bigger businesses with partners is a significant hurdle at times.
- **Full Confidentiality:**

  Secrecy is paramount in modern businesses given the ferocious competition. There is no leak of inside information in this business model, making it arguably the safest type of business.
- **Direct Incentive:**

  The owner alone gets to enjoy all profits- the fruits of labour. He will also retain any benefits apart from revenues that a business may generate.
- **Ease of formation and Closure:**

  Should there be losses in operations and the business proves untenable, a sole proprietor is free to close the rm down. He can always use the leftover capital or profits hitherto generated for other purposes.

Disadvantages of a Sole Proprietorship

The following are some major limitations of self-proprietorship.

- **Resources Limited:**

  A single owner does not have access to a large corpus initially. He may have to take a bank loan or ask relatives or friends for loans. If his business fails to take off, he will have difficulty repaying.
- **Lack of Continuity (Limited life of a business concern):**

  Yet another disadvantage of sole proprietorships is a lack of continuity of a business' life-cycle. If the owner dies, his business ceases to exist. While it is true that he can decree that his successor will run the business on his demise or ailment, there is no guarantee that the business will be run as efficiently.

- **Unlimited Liability:**

  Speaking on merits and demerits of a sole proprietorship, this is a major demerit. A sole owner has to carry the burden of unlimited liability. For example, in direct relation to point A of this section, creditors may also seek compensation from the owner's private estate if he is unable to repay loans. It is a significant deal-buster for many would businesspersons are aware of this risk.

- **Limited Expertise:**

  Running a business requires a lot of varying expertise in different elds. There has to be clarity on operations, client relationships, margin setting, accounts, and so on. Technological know-how is also crucial. For a single owner, these elements present unique challenges.

Partnership

In India, we have a definite law that covers all aspects and functioning of a partnership, The Indian Partnership Act 1932. The act also defines a partnership as "the relation between two or more persons who have agreed to share the profits from a business carried on by either all of them or any of them on behalf of/acting for all"

So in such a case two or more persons come together as a unit to achieve some common objective. And the profits earned in pursuit of this objective will be shared amongst themselves. The entity is collectively called a "Partnership Firm" and all the individual members are the "Partners".

Features of a Partnership

- ### Formation/Partnership Agreement

A partnership firm is not a separate legal entity. But according to the act, a firm must be formed via a legal agreement between all the partners. So a contract must be entered into to form a partnership firm. Its business activity must be lawful, and the motive should be one of profit.

- **Unlimited Liability**

In a unique feature, all partners have unlimited liability in the business. The partners are all individually and jointly liable for the firm and the payment of all debts. This means that even personal assets of a partner can be liquidated to meet the debts of the firm.

If the money is recovered from a single partner, he can, in turn, sue the other partners for their share of the debt as per the contract of the partnership.

- **Risk bearing/Sharing of Profit and Loss:**

Another significant component of the partnership is, the accord between partners has to share gains and losses of a trading concern. However, the definition held in the Partnership Act elucidates – partnership as an association between people who have consented to share the gains of a business, the sharing of loss is implicit. Hence, sharing of gains and losses is vital.

- **Decision making and control:**

In sole proprietorship one person was taking all the decision but here in the partnership firm all the decision related to business are made with the consultation from each partner in democratic way (mutually agree). All the efforts and research activities are done by all the partners.

- **Continuity**

A partnership cannot carry out in perpetuity. The death or retirement or bankruptcy or insolvency or insanity of a partner will dissolve the firm. The remaining partners may continue the partnership if they so choose, but a new contract must be drawn up. Also, the partnership of a father cannot be inherited by his son. If all the other partners agree, he can be added on as a new partner.

- **Number of Members**

As we know that there should be a minimum of two members. However, the maximum number will vary according to a few conditions. The Partnership Act itself is silent on this issue, but the Companies Act, 2013 provides clarity.

For a banking business, the number of partners must not exceed ten. For a business of any other nature, the maximum number is twenty. If the number of partners increases it will become an illegal entity or association.

- **Mutual Agency**

In this type of organisation, the business must be carried out by all the partners together. Or alternatively, it can be carried out by any of the partners (one or several) acting for all of them or on behalf of all of them. So this means every partner is an agent as well as the principal of the partnership. He represents the other partners in some cases so he is their agent.

Advantages of a business partnership

The business partnership offers a lot of advantages to those who choose to use it.

- **Ease of doing business**

The partners can agree to create the partnership verbally or in writing. There's no need to register with Companies House and registering the business partnership for taxation with HMRC is quite simple. The partners will also individually need to register for self-assessment, which they can do online.

Although it will take longer and incur additional cost, it's usually sensible to put in place a partnership agreement. This documents how the partnership will work, the rights and responsibilities of partners and what would happen in various possible situations, including if the partners fundamentally disagree or someone wants to leave.

- **Better decision-making**

Compared with operating on your own, in a partnership the business benefits from the unique perspective brought by each partner. In business, very often two heads really are better than one, with the combined conclusion of debating a situation far better than what each partner could have achieved individually.

- **More partners, more capital**

The more partners there are, the more money there may be available from their combined resources to invest into the business, which can help to fuel growth. Together, their borrowing capacity is also likely to be greater.

- **Privacy**

Compared to a limited company, the affairs of a partnership business can be kept confidential by the partners. By contrast, in a limited company certain documents are available for public inspection at Companies House and a company's shareholders can choose to inspect various registers and other documents the company is required to keep.

- **Sharing Risk –**

  All loss incurred by the firm is equally distributed amongst each partner.

Disadvantages of a business partnership

- **Unlimited liability**

Again because the business does not have a separate legal personality, the partners are personally liable for debts and losses incurred. So if the business runs into trouble your personal assets may be at risk of being seized by creditors, which would generally not be the case if the business was a limited company.

The partners are jointly and severally liable. As one partner can bind the partnership, you can effectively find yourself paying for the actions of the other partners. If your partners are unable to settle debts, you'll be responsible for doing so. In an extreme example where you only own 10% of the partnership, if your partners have no assets you might end up having to settle 100% of the debts of the partnership and need to sell your possessions in order to do so.

- **Limited Capital:**

  As the partnership business is established and managed by a few partners, it has less chance of accumulating a large amount of capital. In comparison to the joint stock company, the partnership has less capital.

- **Problem of dispute (Conflict):**

Even though the partnership business }rm is formed by the agreement of partners, the partners may not agree all the time. The partners may disagree regarding the pro}t and use of authority. This dispute between partners may create a problem in the existence of a business.

- **Uncertain existence (Lack of continuity):**

A partnership business may face dissolution in case of death, insolvency or mental or physical illness of active partners. The partnership of business could be shut down by the partner after making the agreement between them. Therefore, it has an uncertain existence.

- **Lack of public faith:**

Since the partnership business has limited sizes, non-existence in the eye of the law, it has less public faith. The public doesn't believe in partnership business as much as the joint stock company because it has difficulty in both expansion and growth.

Cooperative Society

'Cooperative Society' is intended to help each other. Thus, cooperatives are those institutions which are formed for mutual assistance of its members. The cooperative movement is mainly the movement of the poor. Cooperative organisations are formed to serve their members. The weaker sections of the society can create such organisations to protect themselves from exploitation through modern means of production and distributions. A cooperative society is a voluntary organisation of individuals who are mostly workers and small producers. They are organised under joint management on democratic methods to improve their domestic and business conditions and capital collection.

Features of a Cooperative Society

- **Voluntary Membership:**

  As it is a voluntary association, the membership is also voluntary. A person is free to join a cooperative society, and can also leave anytime as per his desire. Irrespective of their religion, gender & caste, membership is open to all.

- **Legal status:**

  It is compulsory for the co-operative society to get registration. The co-operative society is a separate legal identity to the society.

It does not get affected by the entry or exit of its members.

- **Limited liability**

There is limited liability of the members of co-operative society. Liability is limited to the extent of the amount contributed by members as capital.

- **Control:**

An elected managing committee has the powers to take decisions. Members have the right to vote, by which they elect the members who will constitute the managing committee.

- **Service motive**

The cooperative society works on the principle of mutual help & welfare. Hence, the principal of service dominates it's working. If any surplus is generated, it is distributed amongst the members as a dividend in conformity with the bye-laws of the society.

Cooperative Society- Advantages:

- **Democratic Management-**

A cooperative society is managed in a democratic manner. It is based on the principle of 'one man one vote'. All members have equal rights and can have a voice in its management.

- **Limited Liability-**

The liability of the members of a co-operative society is limited to the extent of capital contributed by them. They do not have to bear personal liability for the debts of the society.

- **Stability-**

A co-operative society has a separate legal existence. It is not affected by the death, insolvency, lunacy or permanent incapacity of any of its members. It has a fairly stable life and continues to exist for a long period.

- **Economical Operations-**

The operation of a cooperative society is quite economical due to elimination of middlemen and the voluntary services provided by its members.

- **Government Patronage**-

Government gives all kinds of help to co-operatives, such as loans at lower rates of interest and relief in taxation.

- **Easy to Form-**

A cooperative society is a voluntary association and may be formed with a minimum of ten adult members. Its registration is very simple and can be done without much legal formalities.

Cooperative Society- Disadvantages:

- **Limited Capital-**

Cooperatives are usually at a disadvantage in raising capital because of the low rate of return on capital invested by the members.

Inefficient Management-

The management of a co-operative society is generally inefficient because the managing committee consists of part-time and inexperienced people. Qualified managers are not attracted towards a cooperative on account of its limited capacity to pay adequate remuneration.

- **Lack of Secrecy-**

The affairs of a co-operative society are openly discussed in the meetings of the members. Every member is free to inspect the books and records of the society. Therefore, it becomes difficult to keep the secrets of business.

- **Government Intervention:**

The daily operations of a cooperative society are subject to government rules and regulations. Regular book-keeping, auditing and inspection of accounts by the government officials are mandatory aspects of the organisation. The reports have to be submitted to the registrar. All these legal formalities take a lot of time and consequently inhibit efficiency.

- **Conflict among Members:**

The members of cooperative society come from different walks of life. Often, their views on important issues may differ from each other leading to strong resentment and disharmony among them. Some ambitious members also want to control the functions of the organisation. Blinded by the society, thus, crippling its efficiency.

Company

A company is a natural legal entity formed by the association and group of people to work together towards achieving a common objective.

According to the definition of a company by the Indian Act 2013;

‘‘A registered association which is an artificial legal person, having an independent legal, entity with perpetual succession, a common seal for its signatures, a common capital comprised of transferable shares and carrying limited liability.’’

Features of Company

- **Separate Legal Entity**

When we say legal entity, what it means that it’s completely independent of its people who control its operations. In other words, the company won’t be responsible if its members don’t pay their debt. The same goes for the company as well; that the members don’t have to pay for the debt of the company, if it’s unable to pay to its creditors.

- **Common Seal**

As we know that a company acts as an artificial legal individual, therefore, it has a stamp or seal with the name and address engraved on it. This stamp would be like the signature of the company. The stamp and company’s seal is used for the verification and authorization of various documents.

- **Separation of Ownership and Management**

A company may have multiple shareholders and, in several cases, the number of shareholders may be large enough to be responsible for managerial affairs. So, shareholders usually hire directors who take the responsibility of running all the daily operations of a company.

- **Artificial person**

The law treats the company as a legal artificial person because it has its name and bank accounts. It can also own property under its name, file a lawsuit against other companies or personals, or be partnered up with other companies. It performs all of the activities that a person can legally do; a company can do it well. Therefore, it acts as an artificial individual.

- **Perpetual Existence**

Unlike proprietorship, partnership or any other type of business, a company doesn't depend upon its owners, board of directors, shareholders, or employees. Many people come and go in the company, but it stays. Therefore, the existence of the company is much stable than

- **Transferability of Shares:**

Shareholders of a public limited company can transfer their shares as per the rules laid down in the articles of association. However, in case of a private limited company, there might be some restrictions on the transfer of shares.

- **Limited Liability**

The liability of shareholders is limited to their share price only; it is in the limited companies by share. On the other hand, in the case of limited companies by guarantee, where the share of contributors is like an asset in the company; if the company goes bankrupt, then the shareholders have to pay a small amount to cover up the loss of the company.

Company-Advantages

- **Limited Liability:**

The liability of shareholders, unless and otherwise stated, is limited to the face value of shares held by them or guarantee given by them.

- **Perpetual Existence:**

Deaths, insanity, insolvency of shareholders or directors do not affect the company's existence. A company has a separate legal entity with perpetual succession.

- **Expansion Potential:**

As there is no limit to the maximum number of shareholders in a public limited company, expansion of business is easy by issuing new shares and debentures. Companies normally use their reserves for expansion purposes.

- **Transferability of Shares:**

If the shareholders of a company are displeased with the progress of the business, they can sell their shares any time. During all this change of ownership, the business continues to operate.

The shareholder can withdraw the profitable amount also from the existing company anytime and invest it in any other company.

- **Professional Management:**

In company business, the management is in the hands of the directors who are elected by the shareholders and are well experienced persons. In order to manage the day-to-day activities, salaried professional managers are appointed. Thus, the company business offers professional management.

- **Diffusion of Risk:**

As the membership is very large, the whole business risk is divided among the several members of the company. This is an advantage particularly for small investors.

Disadvantages of Company:

- **Complexity of a formality:**

Compared to proprietorship and partnership, a company has to comply with more legal requirements. It consumes considerable time and effort.

- **Lack of Secrecy:**

As per the legal provisions, a company has to make various statements available to the Registrar of the Companies, Financial Institutions; the secrecy of business comes down. It is further reduced when the company provides its annual report to the shareholders as the competitors do also find out the details of all financial data.

- **Delay in Decision-making:**

In company form of organization no single individual can make a policy decision. All important decisions are taken either by the Board of Directors or are referred to general house. Decision-taking process is time consuming. If some business opportunity arises and a quick decision is needed, it will not be possible to arrange meetings all of a sudden. So many opportunities may be lost because of a delay in decision-making.