Business Studies Notes PDF

On

Nature and Purpose of Business

(Class – 11 / Chapter- 2)

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

Various forms of business organisations from which one can choose the right one include:
(a) Sole proprietorship
(b) Joint Hindu family business
(c) Partnership
(d) Cooperative societies
(e) Joint stock company

SOLE PROPRIETORSHIP

Sole proprietorship means a business owned, financed and controlled by a single person who is recipient of all profit and bearer of all risks.
It is SUITABLE IN AREAS OF PERSONALISED SERVICE like beauty parlour, hair cutting saloons & small scale activities like retail shops.

FEATURES

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

MERITS

1. Ease of formation and closure: Business can be established and closed with the consent of all the partners as the registration is optional.
2. Balanced decision making: All the decisions are taken by consent partners as partners undertake responsibilities as per their expertise.
3. More funds: Funds are provided by all the partners, which increases the scope for large-scale business operation.
4. Unlimited liability: The liability of the owner is unlimited. In case the assets of business are not sufficient to meet its debts, the personal property of owner can be used for paying debts
5. No legal formalities: are required to start, manage and dissolve such a business organization.

LIMITATIONS:

1. Limited capital is the form of only the personal savings and borrowings of the proprietor.
2. Lack of specialization in various managerial functions as the proprietor manages the business all alone
3. Risk to the personal assets of the proprietor, as these assets may be used for debt repayments if there is any shortage of funds
4. Risk of closure caused by such situations as the deaths aliment or bankruptcy of the sole proprietor or other adverse situations
5. Limited scope for expansion:- Due to limited capital and managerial skills, it cannot expand to a large scale.

JOINT HINDU FAMILY BUSINESS-

Joint Hindu family business is a specific form of business organisation found only in India. Owned and run by the members of Hindu undivided family. Governed by the Hindu Succession Act, 1956 and managed by the eldest member of the family known as KARTA.

FEATURES

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

2. Membership by birth – There are two systems which govern membership

- Dayabhaga System
- Mitakshara System

3. Liability – Liability of KARTA is unlimited but of all other members is limited to the extent of their share in property

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

5. Minor members – A minor can also become a fully fledged member of Family business.

MERITS

1. Effective control - Complete control by the KARTA enables proper administrative control and quick decision-making

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

3. Limited liability- The liability of all the members or co-partners (except the KARTA) is limited to the extent of their share in the family business.

4. Secrecy – Complete secrecy regarding business decisions can be maintained by KARTA.

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

LIMITATIONS

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

2. Unlimited liability of KARTA – It makes him less enterprising.

3. Dominance of KARTA - All the decisions are taken by him, which at times may not be acceptable to others members of the family.

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

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

PARTNERSHIP

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

FEATURES

1. Two or more persons: There must be at least two persons to form a partnership. The maximum no. of persons is 10 in banking business and 20 in non-banking business.

2. Agreement: It is an outcome of an agreement among partners which may be oral or in writing.

3. Lawful business- It can be formed only for the purpose of carrying on some lawful business.

4. Decision making & control – Every partner has a right to participate in management & decision making of the organisations.

5. Unlimited liability – Partners have unlimited liability.
6. Mutual Agency – Every partner is an implied agent of the other partners and of the firm. Every partner is liable for acts performed by other partners on behalf of the firm.
7. Lack of continuity – Firms existence is affected by the death, Lunacy and insolvency of any of its partner. It suffers from lack of continuity.

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

LIMITATIONS
1. Limited resources – There is a restriction on the number of partners and hence capital contributed by them is also limited.
2. Unlimited liability- The liability of partners is unlimited and they are liable individually as well as jointly. It may prove to be a big drawback for those partners who have greater personal wealth. They will have to repay the entire debt in case the other partners are unable to do so.
3. Lack of continuity – Partnership comes to an end with the death, retirement, insolvency or lunacy of any partner. It may result in lack of continuity.
4. Lack of public confidence – Partnership firms are not required to publish their reports and accounts. Thus they lack public confidence.
5. Possibility of conflicts- Partnership is run by a group of persons wherein decision making authority is shared. Difference in opinion on some issues may lead to disputes between partners.

TYPES OF PARTNERS
1. Active partner: An active partner is one who contributes capital, participates in the management of the firm, shares its profits and losses, and is liable to an unlimited extent to the creditors of the firm.
2. Sleeping or dormant partner: Partners who do not take part in the day to day activities of the business are called sleeping partners.
3. Secret Partner – He participates in business secretly without disclosing his association with the firm to general public. His liability is also unlimited.
4. Nominal partner: A nominal partner is one who allows the use of his/her name by a firm, but does not contribute to its capital.
5. Partner by Estoppels – He is the one who by his words or conduct gives the impression to the outside world that he is a partner of the firm whereas actually he is not. His liability is unlimited towards the third party who has entered into dealing with the firm on the basis of his pretensions.
6. Partner by holding out – He is the one who is falsely declared partner of the firm whereas actually he is not. And even after becoming aware of it, he doesn't deny it. His liability is unlimited towards the party who has dealt with the firm on the basis of this declaration.

Types of Partnership
A. Classification on the Basics of Duration
Partnership at will- This type of partnership exists at the will of partners.

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

B. Classification on the basis of Liability

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

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

PARTNERSHIP DEED

A partnership deed is a document containing all the terms and conditions of a partnership. Preparations of a partnership deed prevents misunderstandings and conflicts among the partners.

A partnership deed generally has the following components:

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

REGISTRATION OF PARTNERSHIP

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

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

Co-operative Society

A co-operative society is formed when individuals voluntarily come together to protect and promote their common interests.

FEATURES

1. Voluntary association: Everyone having a common interest is free to join a co-operative society and can also leave the society after giving proper notice.

2. Legal status: Its registration is compulsory and it gives it a separate legal identity.

3. Limited liability: The liability of the members of a cooperative society is limited to the extent of the amount contributed by them as capital.

4. Control: In a cooperative society, the power to take decisions lies in the hands of an elected managing committee. Every member has one vote irrespective of the number of shares held by him.

5. Service motive: The main aim is to serve its members and not to maximize the profit.

MERITS

1. Equality in voting status: The principle of 'one man one vote' governs the cooperative society.

2. Limited Liability: The liability of members is limited to the extent of their capital contribution.

3. Stable existence: Death, bankruptcy or insanity of the members do not affect continuity of a cooperative society.
4. Economy in operations: Due to elimination of middlemen and voluntary services provided by its members.
5. Government Support: Govt. provides support by giving loans at lower interest rates, subsidies & by charging less tax.
6. Ease of formation: The cooperative society can be started with a minimum of ten members. Its formation is governed by the provisions of Cooperative Societies Act 1912.

LIMITATIONS
1. Shortage of capital – It suffers from shortage of capital as it is usually formed by people with limited means.
2. Inefficient management – Co-operative society is managed by elected members who may not be competent and experienced. Moreover, it can't afford to employ expert and experienced people at high salaries.
3. Lack of motivation – Members are not inclined to put their best efforts as there is no direct link between efforts and reward.
4. Lack of Secrecy – Its affairs are openly discussed in its meeting which makes it difficult to maintain secrecy.
5. Excessive govt. control – it suffers from excessive rules and regulations of the government. It has to get its accounts audited by the auditor and has to submit a copy of its accounts to the registrar.

TYPES OF CO-OPERATIVE SOCIETIES
(i) Consumer's cooperative societies: The consumer cooperative societies are formed to protect the interests of consumers. The members are consumers desirous of obtaining good quality products at reasonable prices.
(ii) Producer's cooperative societies: These societies are set up to protect the interest of small producers. The members are producers desirous of procuring inputs for production of goods to meet the demands of consumers.
(iii) Marketing Co-operative Society – It performs various marketing function such as transportation, warehousing, packing, grading, marketing research etc. for the benefit of its members. The production of different members is pooled together and sold by society at a good price.
(iv) Farmer's cooperative societies: These societies are established to protect the interests of farmers by providing better inputs at a reasonable cost. The aim is to gain the benefits of large scale farming and increase productivity.
(v) Credit cooperative societies: Credit cooperative societies are established for providing easy credit on reasonable terms to the members. The members comprise of persons who seek financial help in the form of loans.
(vi) Co-operative Housing Society – The main aim is to provide houses to people with limited means/income at a reasonable price.

JOINT STOCK COMPANY
A joint stock company is a form of business organisation wherein a group of persons form an association in order to perform business activities together. It is considered to be the most superior form of business. **FEATURES**
1. Incorporated association – The company must be incorporated or registered tender under the companies Act 1956. Without registration no company can come into existence.
2. Separate Legal Existence – It is created by law and it is a distinct legal entity independent of its members. It can own property, enter into contracts, can file suits in its own name.
3. Perpetual Existence – Death, insolvency and insanity or change of members as no effect on the life of a company. It can come to an end only through the prescribed legal procedure.
4. Limited Liability – The liability of every member is limited to the nominal value of the shares bought by him or to the amt. guaranteed by him. Transferability of shares – Shares of public Co. are easily transferable. But there are certain restrictions on transfer of shares of private Co. Common Seal- It is the official signature of the company and it is affixed on all important documents of the company.

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

MERITS

1. Limited Liability – The liability of the shareholders is limited to the amount paid by them for the shares purchased.
2. Transfer of Interest – Easy transferability of shares increases the attractiveness of shares for investment.
3. Perpetual Existence – A joint stock company enjoys perpetual existence and does not face closure by itself even if all its members pass away.
4. Scope for expansion – A company can collect a huge amount of capital from unlimited members who are ready to invest because of limited liability, easy transferability and chances of high return.
5. Professional management – Generally, a joint stock company hires professionals and specialized managers for handling its complex operations.

LIMITATIONS

1. Legal formalities – The procedure of formation of Co. is very long, time consuming, expensive and requires a lot of legal formalities to be fulfilled.
2. Lack of secrecy – It is very difficult to maintain secrecy in the case of a public company, as the company is required to publish and file its annual accounts and reports.
3. Lack of Motivation – Divorce between ownership and control and absence of a direct link between efforts and reward lead to lack of personal interest and incentive.
4. Delay in decision making – Red papism and bureaucracy do not permit quick decisions and prompt actions. There is little scope for personal initiative.
5. Oligarchic management – It is owned by the shareholders, whereas its management and control are handled by the board of directors. Moreover, the owners have little influence over the control and function of the company.

TYPES OF COMPANIES

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

Difference between Private Company & Public Co.

Private Co.	Public Co.
It has minimum 2 and maximum 50 members.	It has minimum 7 and maximum unlimited.
It cannot invite the general public to buy its shares and debentures.	It invites the general public to buy its shares and debentures.
There are certain restrictions on transfer of its shares.	Its shares are freely transferable.
It can commence business after incorporation.	It can commence business after obtaining a certificate of commencement of business.

It has to write Private Ltd. After its name Ex- Tata Sons, Citi Bank, Hyundai Motor India.	It has to write only limited after its name Ex- Reliance Industries Ltd., Wipro Ltd. Raymond's Ltd.
Its minimum capital required is one lakh.	Its minimum capital required is five lakhs.

Choice of Form of Business Organisation

- **Cost and ease in setting up the organisation:** It is easy to start sole proprietorship with minimum cost and legal requirements whereas formation of a company is a complex task with lengthy legal procedure. But partnership has the advantage of less legal requirements with low cost.
- **Liability:** In sole proprietorship and partnership, the liability of owner or partners is unlimited but in cooperative societies and companies, members have limited liability.
- **Continuity:** In sole proprietorship and partnership, continuity is affected by death and insolvency of the owners but cooperative societies, companies and Hindu undivided family enjoy perpetual existence.
- **Management ability:** In sole proprietorship, it is difficult that the owner may have expertise in all functions but in other forms of business, division of work is possible which leads to better decision making.
- **Capital consideration**: In case of large scale of operation, company form is more suitable but in case of small scale of operation, partnership or sole proprietorship can be chosen.
- **Degree of control:** If the owner wants all the control in his hand the sole proprietorship may be preferred but if the owner is ready to share control, then he can adopt partnership or company form.
- **Nature of business:** For trading and services, sole proprietorship and partnership form can be chosen. For manufacturing, a company form of organisation can be adopted.