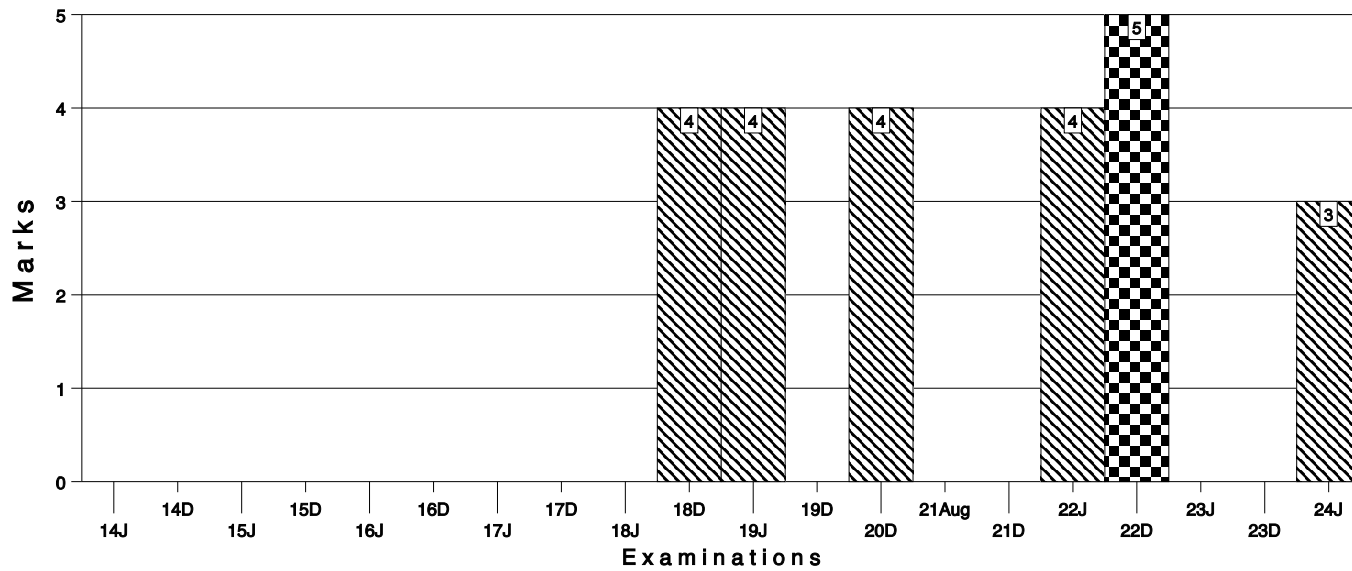


Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend



1

SELECTION OF BUSINESS ORGANISATION

THIS CHAPTER INCLUDES

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|---|---|
| 1. Types of Business Organizations | 9. One Person Company |
| 2. Key Features of various Business Organizations | 10. Private Company |
| 3. Sole Proprietorship | 11. Public Company |
| 4. Partnership Firm | 12. Selection of a Business Organization |
| 5. Hindu Undivided Family (HUF) | 13. Factors governing the decisions for suitable form of organization |
| 6. Limited Liability Partnership (LLP) | 14. Company as a choice of business Organization for Start-Ups |
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CHAPTER AT A GLANCE

Choice of a Business Organisation

The choice of a business entity will depend on an object, nature and size of the business of such entity which will be varied from case-to-case basis and will also depend upon the will of the owners of the business entity which they want to accomplish.

The main types of business entities in India are Sole Proprietorship, Partnership, Hindu Undivided Family (HUF) Business, Limited Liability Partnership (LLP), Co-operative Societies, Branch Office and Company which may be any kind of company including one person company (OPC), private limited company, public limited company, guarantee company, subsidiary company, statutory company, insurance company or unlimited company. Further, Company formed under section 8 of the Companies Act, 2013.

Factors governing the decisions for suitable form of organisation**1. Nature of Business Activity:**

This is an important factor having a direct bearing on the choice of a form of ownership. In small trading businesses, professions, and rendering of personal services, sole-proprietorship is predominant.

2. Scale of Operations:

The second factor that affects the form of business organisation is the scale of operations. If the scale of operations of business activities is small, sole proprietorship or a One Person Company (OPC) is suitable; if the scale of operations is modest – neither too small nor too large – partnership or limited liability partnership (LLP) is preferable; whereas, in case of large scale of operations, the company form is advantageous.

3. Capital Requirements:

Capital is one of the most crucial factors affecting the choice of a particular form of ownership organisation.

Requirement of capital is closely related to the type of business and scale of operations. Enterprises requiring heavy investment (like iron and steel plants, large scale infrastructure projects, etc.) should be organised as companies.

4. Managerial Ability:

It is difficult for a sole proprietor to have expertise in all functional areas of business. Further, the size of the business may not permit engagement of professional management.

5. Degree of Control and Management:

The degree of control and management that an entrepreneur desires to have over business affects the choice of form of organisation. In sole proprietorship and OPC, ownership, management, and control are completely fused, and therefore, an entrepreneur has complete control over his business.

6. Degree of Risk and Liability:

The size of risk and the willingness of owners to bear it, is an important consideration in the selection of a form of business

organisation. The amount of risk involved in a business depends, among other factors like, on the nature and size of business. Smaller the size of business, smaller the amount of risk.

7. Stability of Business:

Stability of business is another factor that governs the choice of an ownership organisation. A stable business is preferred by the owners in so far as it helps him in attracting suppliers of capital who look for safety of investment and regular return, and also helps in getting competent workers and managers who look for security of service and opportunities of advancement.

8. Flexibility of Administration:

As far as possible, the form of organisation chosen should allow flexibility of administration. The flexibility of administration is closely related to the internal organisation of a business, i.e., the manner in which organisational activities are structured into departments, sections, and units with a clear definition of authority and responsibility.

9. Division of Profit:

Profit is the guiding force of private business and it has a tremendous influence on the selection of a particular form of business organisation. An entrepreneur desiring to pocket all the profits of business will naturally prefer sole proprietorship.

10. Costs, Procedure, and Government Regulation:

This is also an important factor that should be taken into account while choosing a particular form of organisation. Different forms of organisation involve different procedure for establishment and are governed by different laws which affect the immediate and long-term functioning of a business enterprise. From this point of view, sole proprietorships are the easiest and cheapest to get started.

11. Tax Implication:

In the choice of the form of business organisation, tax implication plays an important factor. In smaller entities, such as sole proprietorship or partnership, tax liability is dependent on the extent of profits.

12. Geographical Mobility:

The extent to which the product or service is proposed to be manufactured or made available also plays a vital role in choosing the type of business organisation. If a concern deals with local market, a seasonal product or perishable goods, or is meant to cater to a specific city or locality, then sole proprietorship or partnership form of business may be suitable.

13. Transferability of Ownership:

Sole proprietorship, being a one-person entity does not lend itself to transferability of ownership as the owner himself enjoys the profits and suffers the losses in his business. Partnership form of organisation is one where two or more partners share the profits and/or losses in the agreed proportion.

14. Managerial Needs:

Managerial and administrative requirements also affect the decision about the form of organisation. When the concern is small and it caters to local needs only then one person will be enough to manage the business. Sole – proprietorship form of organisation will be suitable for such a business.

15. Secrecy:

Secrecy is of supreme importance, particularly in small business concerns. Accordingly, the entrepreneur would select the sole proprietorship for that reason. In case, he has partners, he will have to carefully weigh whether other partners will be able to maintain the secrecy.

16. Independence:

The company is subject to strict government regulations. So, if the entrepreneur wants to have a freedom in business with little governmental interference, he has to go for either sole proprietorship or partnership.

DESCRIPTIVE QUESTIONS

2018 - Dec [2A] (Or) (i) Ankur has passed out MBA from a premier institution. He wants to become an entrepreneur but he is confused in choosing the form of ownership. Advise Ankur on the aspects which he should consider before deciding the form of ownership. **(4 marks)**

Answer:

One of the first decisions that is faced by an entrepreneur is how the business should be structured. All businesses must adopt some legal configuration that defines the rights and liabilities of participants in the business's ownership, control, personal liability, life span and financial structure.

This decision will have long term implications, so he has to select the form of ownership that is right for him.

In making a choice, he (in our case, Ankur) should take into account the followings:

- His vision regarding the size and nature of business;
- The level of control he wishes to have;
- The level of structure", he is willing to deal with;
- The business's vulnerability to litigation;
- Tax implications of the different organizational structures; Expected profit or loss of the business;
- Whether or not, he will need to re-invest earnings into the business; and His need for access to cash out of the business for himself.

2019 - June [2A] (Or) Comment on the following:

- (iv) Requirement of Capital affects the choice of suitable form of a business organization. **(4 marks)**

Answer:

- Capital is one of the most crucial factors affecting the choice of a particular form of ownership of an organization.
- Requirement of capital is closely related to the type of business and scale of operations. Enterprises requiring heavy investment (like iron and steel plants, large scale infrastructure projects, etc.) should be organized as companies.

- Depending on the capital required, they can be set up as public companies and in some cases, may be in the form of listed companies by raising money from the public and being listed on the stock exchanges.
- Enterprises requiring small investment (like retail business stores, personal service enterprises, etc.) can be best organized as sole proprietorships or even as Partnerships.
- Apart from the initial capital required to start a business, the future capital requirements — to meet modification, expansion, and diversification plans — also affect the choice of form of organization.
- In sole proprietorship, the owner may raise additional capital by borrowing, by purchasing on credit, and by investing additional amounts himself. Banks and suppliers, however, will look closely at the proprietor's individual financial resources before sanctioning any loans or advances.
- Partnerships can often raise funds with greater ease, since the resources and credit of all partners are combined in a single enterprise. Companies are usually best able to attract capital because investors are assured that their liability will be limited, their operations are in public domain in a transparent manner, easily accessible and the ownership can be transferred to other investors.

2020 - Dec [2] (a) X is planning to start a mobile based and web based business. In selection of suitable form of a business organisation, 'degree of control and management' plays a significant role. Explain how this factor affects the choice of form of organisation. **(4 marks)**

Answer:

The degree of control and management that an entrepreneur desires to have over business affects the choice of form of organization.

- (a) **In sole proprietorship and OPC:** ownership, management, and control are completely fused, and therefore, an entrepreneur has complete control over his business.

- (b) **In partnership:** management and control of business is jointly shared by the partners and their specific rights, duties and responsibilities would be documented through incorporating various clauses in this regard in the partnership deed. They have equal voice in the management of partnership business except where they agree to divide among themselves the business responsibilities in a different manner. Even then, they are legally accountable to each other.
- (c) **In a company,** however, there is divergence between ownership and management, the management and control of the company business is entrusted to the Board of Directors who are generally the elected representatives of shareholders. Consequently, a person wishing to have complete and direct control of business prefers proprietary organization rather than partnership or company. If he is prepared to share it with others, he will choose partnership. But, if the activities are large, professional managers are required to handle the day to day affairs and there is need for corporate structure and management, he will prefer the company form of organization.

So, while deciding to commence a business in any form 'X' should just not only consider risk, return, sharing, and control over decision making but should also consider the nature of business and the funding requirement over the period of time.

2022 - June [2A] (Or) (ii) Degree of the Control plays the vital role in selection of a suitable form of the business organization. Explain.

(4 marks)

Answer:

Degree of Control and Management:

1. The degree of control and management that an entrepreneur desires to have over business affects the choice of form of organization.
2. In sole proprietorship and OPC, ownership, management, and control are completely fused, and therefore, an entrepreneur has complete control over his business.
3. In partnership, management and control of business is jointly shared by the partners and their specific rights, duties and responsibilities would be documented through incorporating various clauses in this regard in the

partnership deed. They have equal voice in the management of partnership business except where they agree to divide among themselves the business responsibilities in a different manner. Even then, they are legally accountable to each other.

4. In a company, however, there is divergence between ownership and management, the management and control of the company business is entrusted to the Board, who are generally the elected representatives of shareholders.
5. Thus, a person wishing to have complete and direct control of business prefers proprietary organization rather than partnership or company. If he is prepared to share it with others, he will choose partnership. But, if the activities are large, professional managers are required to handle the day-to-day affairs and there is need for corporate structure and management, he will prefer the company form of organization.

2024 - June [3] (a) "The degree of control and management that an entrepreneur desires to have over business affects the choice of form of organization."

In light of above statement, explain how control and management factor is basic factor to choose the suitable form of organization. **(3 marks)**

PRACTICAL QUESTION

2022 - Dec [1] (a) Sumit Bhasin has an expertise in the field of Modular Kitchen designing, he possesses adequate education too in this field. Now in order to start his venture, he wants to consult a Company Secretary for getting aware of various modes of organization and to select the best mode keeping in view their merits and demerits. As a Company Secretary, make Sumit Bhasin acquainted with available modes of organization while briefing the merits and demerits of each. **(5 marks)**

Answer:

1. In India, there are several forms of business organizations viz, Limited Company, Limited Liability Partnership (LLP), Partnership Firm and Sole Proprietorship. Basically these organizations are classified into

incorporated and unincorporated structures. Company and LLP are the incorporated business organizations and Partnership Firm and Sole Proprietorship are the unincorporated structures. Incorporated business structures are created under respective laws such as Companies Act and LLP Act and will be treated as separate legal entities.

2. While selecting a business organisation, one must have an understanding about the different types of business structures, its merits and demerits, public acceptance and image.
3. **Private Limited Company:** 'Private Limited' form of business is suitable for a team of entrepreneurs (business partners) with formal business relations and want to start a very formal and organized model of business. Also, 'Private Limited' is the best suitable option where the entrepreneurs are expecting external investment to the venture in near future.
4. **Limited Liability Partnership (LLP):** 'LLP' form of business is suitable for a close team of entrepreneurs with formal business relations who do not expect external investors to the venture in near future. LLP can be converted to private limited company at later point when the business is ready for investment. LLP is also suitable for related entrepreneur team (eg. Husband and wife) who want to start a formal business with advantage of limited liability.
5. **One Person Company (OPC):** 'OPC' form of business is suitable for a single entrepreneur who wants to start a business without any business partners and to take advantage of Limited Liability. It is to be noted that addition of shareholders / partners to business in future is not possible to 'One Person Company' form of business.
6. **Partnership:** 'Partnership' form of business is suitable for a team of entrepreneurs with formal business relations or personal repartitions. Partnership is a business defined by a partnership agreement. Partnership is also a formal form of business without the advantage of Limited Liability.

7. **Sole Proprietorship:** 'Proprietorship' from of business is suitable for a single entrepreneur who wants to start a business by self in an informal way. There is no specific registration for a Proprietorship. The proprietor will not get the advantage of Limited Liability and cannot add partners to business at any point of time. Also, a Proprietorship' cannot be converted to OPC / LLP/ Company in future.

Conclusion: Above shall be the advice to Mr. Sumit Bhasin.