TYPES OF BUSINESS ORGANISATIONS

A business is an organization that uses economic resources or inputs to provide goods or services to customers in exchange for money or other goods and services. Business organizations come in different types and forms. There are 4 Types of Business,

1. Service Business

A service type of business provides intangible products (products with no physical form). Service type firms offer professional skills, expertise, advice, and other similar products.

Examples of service businesses are: schools, repair shops, hair salons, banks, accounting firms, and law firms.

2. Merchandising Business

This type of business buys products at wholesale price and sells the same at retail price. They are known as "buy and sell" businesses. They make profit by selling the products at prices higher than their purchase costs. A merchandising business sells a product without changing its form.

Examples are: grocery stores, convenience stores, distributors, and other resellers.

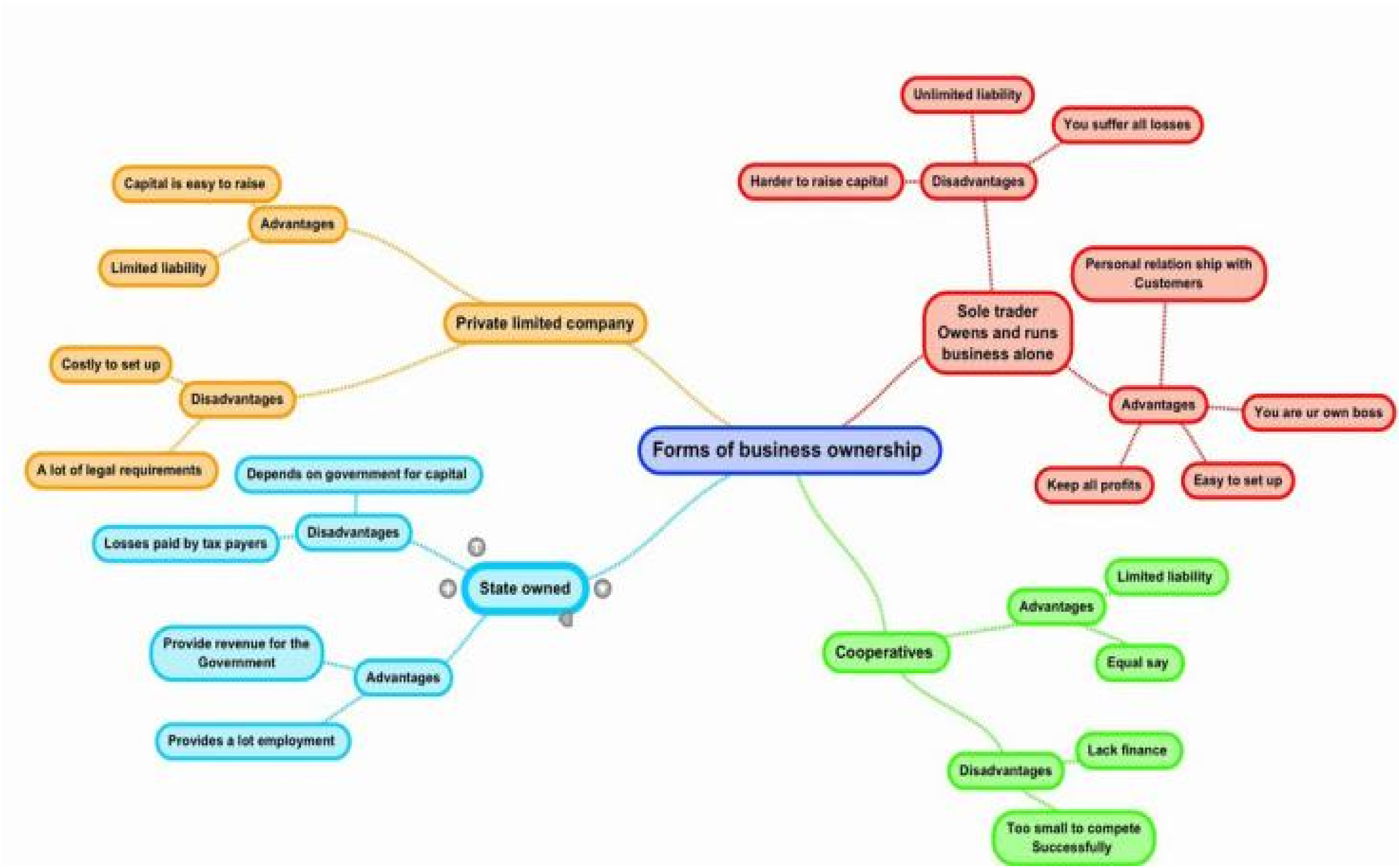
3. Manufacturing Business

Unlike a merchandising business, a manufacturing business buys products with the intention of using them as materials in making a new product. Thus, there is a transformation of the products purchased. A manufacturing business combines raw materials, labor, and factory overhead in its production process. The manufactured goods will then be sold to customers.

4. Hybrid Business

Hybrid businesses are companies that may be classified in more than one type of business. A restaurant, for example, combines ingredients in making a fine meal (manufacturing), sells a cold bottle of wine (merchandising), and fills customer orders (service). Nonetheless, these companies may be classified according to their major business interest. In that case, restaurants are more of the service type – they provide dining services.

Forms of Business Organization



These are the basic forms of business ownership:

1. Sole Proprietorship

- 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.
- 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; meaning, 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.

Characteristics of sole proprietorship form of business organisation

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

(b) No Separation of Ownership and Management: The owner himself/herself manages the business as per his/her own skill and intelligence. There is no separation of ownership and management as is the case with company form of business organisation. A sole proprietor contributes and organises the resources in a systematic way and controls the activities with the objective of earning profit.

(c) Less Legal Formalities: The formation and operation of a sole proprietorship form of business organisation does not involve any legal formalities. Thus, its formation is quite easy and simple.

(d) 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.

(e) 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.

(f) 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 utilised to pay off the liabilities of the business.

(g) One-man Control: The controlling power of the sole proprietorship business always remains with the owner. He/she runs the business as per his/her own will.

Merits of Sole proprietorship

(a) Easy to Form and Wind Up.

(b) Quick Decision and Prompt Action.

(c) Direct Motivation.

(d) Flexibility in Operation.

(e) Maintenance of Business Secrets.

(f) Personal Touch.

Limitations of sole proprietorship

(a) Limited Resources.

(b) Lack of Continuity.

(c) Unlimited Liability.

(d) Not Suitable for Large Scale Operations.

(e) Limited Managerial Expertise.

2. Partnership

- A partnership is a business owned by two or more persons who contribute resources into the entity. The partners divide the profits of the business among themselves.
- In general partnerships, all partners have unlimited liability. In limited partnerships, creditors cannot go after the personal assets of the limited partners.

Characteristics of partnership form of business organisation

Based on the definition of partnership as given above, the various characteristics of partnership form of business organisation, can be summarised as follows:

(a) Two or More Persons: To form a partnership firm atleast two persons are required. 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.

(b) Contractual Relationship: Partnership is created by an agreement among the persons who have agreed to join hands. 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.

(c) Sharing Profits and Business: There must be an agreement among the partners to share the profits and losses of the business of the partnership firm. If two or more persons share the income of jointly owned property, it is not regarded as partnership.

(d) Existence of Lawful Business: The business of which the persons have agreed to share the profit must be lawful. Any agreement to indulge in smuggling, black marketing etc. cannot be called partnership business in the eyes of law.

(e) Principal Agent Relationship: There must be an agency relationship between the partners. Every partner is the principal as well as the agent of the firm. When a partner deals with other parties he/she acts as an agent of other partners, and at the same time the other partners become the principal.

(f) Unlimited Liability: The partners of the firm have unlimited liability. They are jointly as well as individually liable for the debts and obligations of the firms. If the assets of the firm are insufficient to meet the firm’s liabilities, the personal properties of the partners can also be utilised for this purpose. However, the liability of a minor partner is limited to the extent of his share in the profits.

(g) Voluntary Registration: The registration of partnership firm is not compulsory. But an unregistered firm suffers from some limitations which makes it virtually compulsory to be registered. Following are the limitations of an unregistered firm.

(i) The firm cannot sue outsiders, although the outsiders can sue it.

(ii) In case of any dispute among the partners, it is not possible to settle the dispute through court of law.

(iii) The firm cannot claim adjustments for amount payable to, or receivable from, any other parties.

Merits of partnership form

(a) Easy to Form

(b) Availability of Larger Resources

(c) Better Decisions

(d) Flexibility

(e) Sharing of Risks

(f) Keen

(g) Benefits of Specialisation

(h) Protection of Interest

(i) Secrecy

Limitations of partnership form

A partnership firm also suffers from certain limitations. These are as follows:

(a) Unlimited Liability

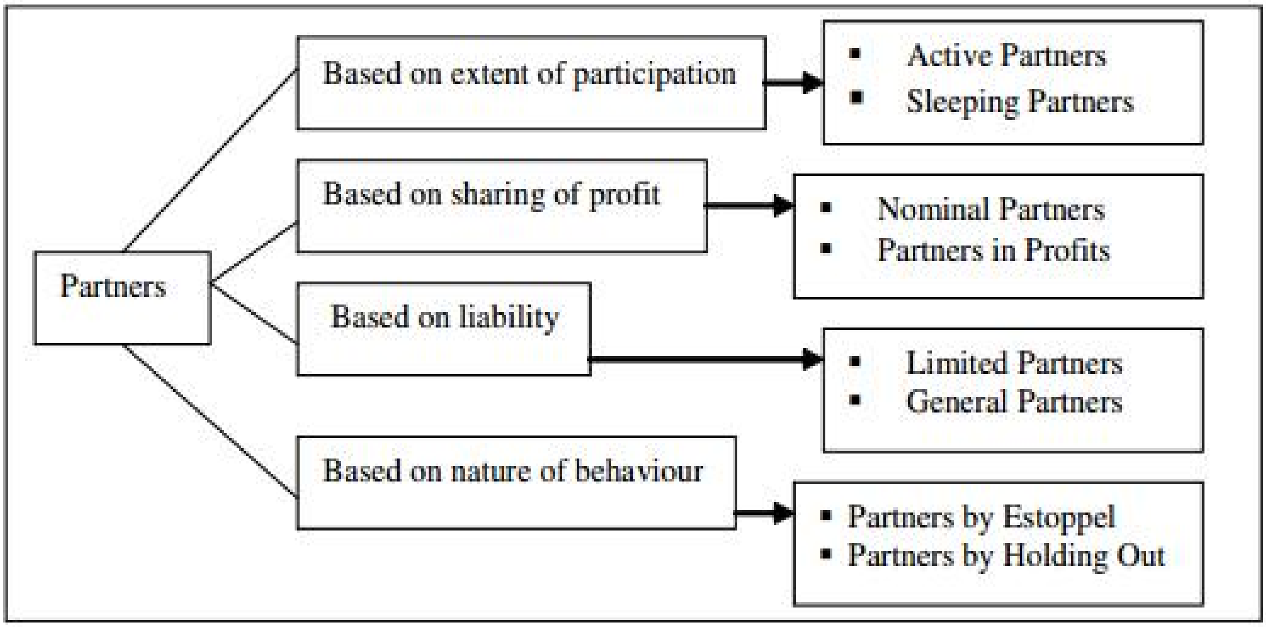
(b) Instability

(c) Limited Capital

(d) Non-transferability of share

(e) Possibility of Conflicts

Types of partners



(A) Based on the extent of participation in the day-to-day management of the firm partners can be classified as 'Active Partners' and 'Sleeping Partners'. The partners who actively participate in the day-to-day operations of the business are known as active partners or working partners. Those partners who do not participate in the day-to-day activities of the business are known as sleeping or dormant partners. Such partners simply contribute capital and share the profits and losses.

(B) Based on sharing of profits, the partners may be classified as 'Nominal Partners' and 'Partners in Profits'. Nominal partners allow the firm to use their name as partner. They neither invest any capital nor participate in the day-to-day operations. They are not entitled to share the profits of the firm. However, they are liable to third parties for all the acts of the firm. A person who shares the profits of the business without being liable for the losses is known as partner in profits. This is applicable only to the minors who are admitted to the benefits of the firm and their liability is limited to their capital contribution.

(C) Based on Liability, the partners can be classified as 'Limited Partners' and 'General Partners'. The liability of limited partners is limited to the extent of their capital contribution. This type of partners is found in Limited Partnership firms in some European countries and USA. So far, it is not allowed in India. However, the Limited liability Partnership Act is very much under consideration of the Parliament. The partners having unlimited liability are called as general partners or Partners with unlimited liability. It may be noted that every partner who is not a limited partner is treated as a general partner.

(D) based on the behaviour and conduct exhibited; there are two more types of partners besides the ones discussed above. These are

(a) Partner by Estoppels; and
(b) Partner by Holding out.

A person, who behaves in the public in such a way as to give an impression that he/she is a partner of the firm, is called ‘partner by estoppels’. Such partners are not entitled to share the profits of the firm, but are fully liable if somebody suffers because of his/her false representation. Similarly, if a partner or partnership firm declares that a particular person is a partner of their firm, and such a person does not disclaim it, then he/she is known as ‘Partner by Holding out’. Such partners are not entitled to profits but are fully liable as regards the firm’s debts.

3. Corporation

- A corporation is a business organization that has a separate legal personality from its owners. Ownership in a stock corporation is represented by shares of stock.
- The owners (stockholders) enjoy limited liability but have limited involvement in the company's operations. The board of directors, an elected group from the stockholders, controls the activities of the corporation.
- In addition to those basic forms of business ownership, these are some other types of organizations that are common today:

4. Limited Liability Company

- Limited liability companies (LLCs) in the USA, are hybrid forms of business that have characteristics of both a corporation and a partnership. An LLC is not incorporated; hence, it is not considered a corporation.
- Nonetheless, the owners enjoy limited liability like in a corporation. An LLC may elect to be taxed as a sole proprietorship, a partnership, or a corporation.
- Memorandum of Association - describes what company has been formed to do

- Articles of Association - internal rules covering:
    - What directors can do
    - Voting rights of shareholders
- Limited liability means that investors can only lose money they have invested.
- Encourages people to finance company
- Limited liability means that they can only recover money from existing assets of business. They cannot claim personal assets of shareholders to recover amounts owed by company.

5. Cooperative

- Cooperative Society is defined as "a society, which has its objectives for the promotion of economic interests of its members in accordance with cooperative principles."
- A cooperative is a business organization owned by a group of individuals and is operated for their mutual benefit. The persons making up the group are called members. Cooperatives may be incorporated or unincorporated.
- Some examples of cooperatives are: water and electricity (utility) cooperatives, cooperative banking, credit unions, and housing cooperatives.

Characteristics of cooperative society

Based on the above definition we can identify the following characteristics of cooperative society form of business organisation:

(a) Voluntary Association: Members join the cooperative society voluntarily i.e., by their own choice. Persons having common economic objective can join the society as and when they like, continue as long as they like and leave the society and when they want.

(b) Open Membership: The membership is open to all those having a common economic interest. Any person can become a member irrespective of his/her caste, creed, religion, colour, sex etc.

(c) Number of Members: A minimum of 10 members are required to form a cooperative society. In case of multi-state cooperative societies the minimum number of members should be 50 from each state in case the members are individuals. The Cooperative Society Act does not specify the maximum number of members for any cooperative society. However, after the formation of the society, the member may specify the maximum member of members.

(d) Registration of the Society: In India, cooperative societies are registered under the Cooperative Societies Act 1912 or under the State Cooperative Societies Act. The Multi-state Cooperative Societies are registered under the Multi-state Cooperative Societies Act 2002. Once registered, the society becomes a separate legal entity and attains certain characteristics. These are as follows.

(i) The society enjoys perpetual succession

(ii) It has its own common seal

(iii) It can enter into agreements with others

(iv) It can sue others in a court of law

(v) It can own properties in its name

(e) State Control: Since registration of cooperative societies is compulsory, every cooperative society comes under the control and supervision of the government. The cooperative department keeps a watch on the functioning of the societies. Every society has to get its accounts audited from the cooperative department of the government.

(f) Capital: The capital of the cooperative society is contributed by its members. Since, the member's contribution is very limited, it often depends on the loan from government and apex cooperative institutions or by way of grants and assistance from state and Central Government.

(g) Democratic Set Up: The cooperative societies are managed in a democratic manner. Every member has a right to take part in the management of the society. However, the society elects a managing committee for its effective management. The members of the managing committee are elected on the basis of one-man one-vote irrespective of the number of shares held by any member. It is the general body of the society which lays down the broad framework within which the managing committee functions.

(h) Service Motive: The primary objective of all cooperative societies is to provide services to its members.

(i) Return on Capital Investment: The members get return on their capital investment in the form of dividend.

(j) Distribution of Surplus: After giving a limited dividend to the members of the society, the surplus profit is distributed in the form of bonus, keeping aside a certain percentage as reserve and for general welfare of the society.

Types of cooperative societies

Some of the important types are given below.

(a) Consumers' Cooperative Societies: These societies are formed to protect the interest of consumers by making available consumer goods of high quality at reasonable price.

(b) Producer's Cooperative Societies: These societies are formed to protect the interest of small producers and artisans by making available items of their need for production, like raw materials, tools and equipments etc.

(c) Marketing Cooperative Societies: To solve the problem of marketing the products, small producers join hand to form marketing cooperative societies.

(d) Housing Cooperative Societies: To provide residential houses to the members, housing cooperative societies are formed generally in urban areas.

(e) Farming Cooperative Societies: These societies are formed by the small farmers to get the benefit of large-scale farming.

(f) Credit Cooperative Societies: These societies are started by persons who are in need of credit. They accept deposits from the members and grant them loans at reasonable rate of interest.

Merits

§ Easy to form

§ Limited liability

§ Open Membership

§ State Assistance

§ Stable life

§ Tax concessions

§ Democratic Management

Limitations

§ Limited Capital

§ Lack of Managerial Expertise

§ Less Motivation

§ Lack of Interest

§ Dependence on Govt.