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FORMS OF BUSINESS ORGANISATION

Question 6:

Explain the following terms in brief

(a) Perpetual succession

(b) Common seal

(c) *Karta*

(d) Artificial person

ANSWER:

(a) *Perpetual succession*: It implies that a company will continue to exist until and unless it is forced by the law to wind up. This implies that a company, as a separate legal entity, cannot come to an end by itself and will continue to operate forever. It will not cease to exist even in situations such as death, retirement or insolvency of any of its members—that is, a company will continue to operate even if all its members die.

(b) *Common seal*: A company is an artificial entity that is created under the law. Unlike human beings, it cannot sign official documents. This is where the role of a common seal becomes important. A common seal is the official signature of a company that is used by its board of directors in almost all the important official documents. The presence of this seal authenticates the documents, and documents with a common seal can be provided as evidence in a court of law.

(c) *Karta*: The term ***karta*** is used for the head of a joint Hindu family who runs a family business. The ***karta*** of a Joint Hindu family is responsible for carrying out the business operations of the family business and exercising full control over the business. He is the eldest member of the family and has unlimited liabilities along with absolute decision-making powers.

(d) *Artificial person*: By the term ***artificial person,*** we mean that a company is created as a separate legal entity under the law and is a juristic person. However, unlike human beings, a company, as an artificial person, cannot breathe or talk, cannot sign its documents and cannot negotiate with its customers. In contrast, like human beings, a company does have its own life that is truly independent of the life of its members. Hence, because of these dissimilarities and similarities, a company is regarded as an artificial person.

Question 1:

What do you understand by a sole proprietorship firm? Explain its merits and limitation?

ANSWER:

In a sole proprietorship form of business, the business is owned, managed and controlled by a single individual who is known as the sole proprietor. As the sole owner of the business, the proprietor becomes the single recipient of all the profits earned by the business and, in the same way, has to bear all losses.

Merits of Sole Proprietorship

A sole proprietor enjoys the following benefits.

(a) ***Ease in formation and closure of business*****:** There are hardly any legal formalities to be fulfilled for setting up a sole proprietorship firm. However, if a proprietor is dealing in drugs and liquor products, then a licence has to be acquired. The procedure for closing down a sole proprietorship firm is also hassle-free and easy.

(b) ***Quick decision making*****:** A sole proprietor enjoys complete control over the business. This makes decision making quick and easy.

(c) ***Direct incentive*****:** A sole proprietor is the sole bearer of all types of risks associated with the business and, at the same time, is the single recipient of all the profits and gains earned in the business. Thus, this direct link between efforts and rewards motivates the sole proprietor to operate the business efficiency and effectively.

Limitations of Sole Proprietorship:

The following are a few limitations of a sole proprietor firm.

(a) ***Limited capital*****:** The financial resources that are available to a sole proprietor are limited merely to this person's personal savings and borrowings that can be raised from relatives and friends. Thus, the amount of capital available to a sole proprietor is limited, which often prevents him or her from expanding the business.

(b) ***Limited managerial abilities*****:** A sole proprietor manages all the core functions such as purchasing, selling and planning. As a result, the benefits of specialisation are not available to a sole proprietor. Also, because of limited resources, a sole proprietor may not be able to employ specialised employees to handle specific business operations.

(c) ***Uncertain life*****:** In the eyes of the law, a sole proprietor and his or her business are regarded as the same entity. In the event of death, insanity, bankruptcy or physical ailment of a sole proprietor, the life of the business is adversely affected.

Question 2:

Why is partnership considered by some to be a relatively unpopular form of business ownership? Explain the merits and limitations of partnership.

ANSWER:

Partnership is considered to be a relatively unpopular form of business ownership because of the various limitations associated with it. These limitations include unlimited liability, limited resources, possibility of conflicts and lack of continuity.

Limitations of Partnership

(a) ***Unlimited liability*****:** In a partnership, all the partners have unlimited liability. This means that if the firm's assets fall short of the requirement for the repayment of the firm's debts, then the personal assets of the partners can be used.

(b) ***Limited resources*****:** A partnership firm faces limited availability of finance, because of the restrictions imposed on the following fronts:

(i) maximum number of partners allowed in a partnership firm by definition

(ii) maximum number of new partners who can be admitted in the firm

Hence, as a result, a partnership firm faces financial constraints, which in turn impedes its growth prospects.

(c) ***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.

Merits of Partnership

(a) ***Easy formation and closure*****:** A partnership firm involves an agreement (either oral or written) between two or more partners. The registration of a partnership firm is not compulsory, which eases its formation. Similarly, a partnership firm can be shut down at any time with the mutual consent of all the partners.

(b) ***Balanced decision making*****:** In a partnership firm, all the decisions related to the business are taken collectively by all the partners. This makes the decision-making process in a partnership firm comparatively more balanced than in any other form of business ownership.

(c) ***Sharing of risks*****:** The risks in a partnership firm are shared jointly by all the partners. As a result, anxiety, burden and stress of the individual partners are shared among all the partners, which reduces the burden on a single partner.