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FORMS OF BUSINESS ORGANISATION

PARTNERSHIP

The inherent disadvantage of the sole proprietorship in financing and managing an expanding business paved the way for partnership as a viable option. Partnership serves as an answer to the needs of greater capital investment, varied skills and sharing of risks

The Indian Partnership Act, 1932 defines partnership as "the relation between persons who have agreed to share the profit of the business carried on by all or any one of them acting for all."

Features

Definitions given above point to the following major characteristics of the partnership form of business organisation.

(i) Formation: The partnership form of business organisation is governed by the Indian Partnership Act, 1932. It comes into existence through a legal agreement wherein the terms and conditions governing the relationship among the partners, sharing of profits and losses and the manner of conducting the business are specified. It may be pointed out that the business must be lawful and run with the motive of profit. Thus, two people coming together for charitable purposes will not constitute a partnership.

(ii) Liability: The partners of a firm have unlimited liability. Personal assets may be used for repaying debts in case the business assets are insufficient. Further, the partners are jointly and individually liable for payment of debts. Jointly, all the partners are responsible for the debts and they contribute in proportion to their share in business and as such are liable to that extent. Individually too, each partner can be held responsible repaying the debts of the business. However, such a partner can later recover from other partners an amount of money equivalent to the shares in liability defined as per the partnership agreement.

(iii) Risk bearing: The partners bear the risks involved in running a business as a team. The reward comes in the form of profits which are shared by the partners in an agreed ratio. However, they also share losses in the same ratio in the event of the firm incurring losses.

(iv) Decision making and control: The partners share amongst themselves the responsibility of decision making and control of day to day activities. Decisions are generally taken with mutual consent. Thus, the activities of a partnership firm are managed through the joint efforts of all the partners.

(v) Continuity: Partnership is characterised by lack of continuity of business since the death, retirement, insolvency or insanity of any partner can bring an end to the business. However, the remaining partners may if they so desire continue the business on the basis of a new agreement.

(vi) Number of Partners: The minimum number of partners needed to start a partnership firm is two. According to section 464 of the Companies Act 2013, maximum number of partners in a partnership firm can be 100, subject to the number prescribed by the government. As per Rule 10 of The Companies (miscelleneous) Rules 2014, at present the maximum number of members can be 50.

(vii) Mutual agency: The definition of partnership highlights the fact that it is a business carried on by all or any one of the partners acting for all. In other words, every partner is both an agent and a principal. He is an agent of other partners as he represents them and thereby binds them through his acts. He is a principal as he too can be bound by the acts of other partners.

Merits

The following points describe the advantages of a partnership firm.

(i) Ease of formation and closure: A partnership firm can be formed easily by putting an agreement between the prospective partners into place whereby they agree to carryout the business of the firm and share risks. There is no compulsion with respect to registration of the firm. Closure of the firm too is an easy task.

(ii) Balanced decision making: The partners can oversee different functions according to their areas of expertise. Because an individual is not forced to handle different activities, this not only reduces the burden of work but also leads to fewer errors in judgements. As a consequence, decisions are likely to be more balanced.

(iii) More funds: In a partnership, the capital is contributed by a number of partners. This makes it possible to raise larger amount of funds as compared to a sole proprietor and undertake additional operations when needed.

(iv) Sharing of risks: The risks involved in running a partnership firm are shared by all the partners. This reduces the anxiety, burden and stress on individual partners.

(v) Secrecy: A partnership firm is not legally required to publish its accounts and submit its reports. Hence it is able to maintain confidentiality of information relating to its operations.

Limitations

A partnership firm of business organisation suffers from the following limitations:

(i) Unlimited liability: Partners are liable to repay debts even from their personal resources in case the business assets are not sufficient to meet its debts. The liability of partners is both joint and several which may prove to be a 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.

(ii) Limited resources: There is a restriction on the number of partners, and hence contribution in terms of capital investment is usually not sufficient to support large scale business operations. As a result, partnership firms face problems in expansion beyond a certain size.

(iii) 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. Further, decisions of one partner are binding on other partners. Thus an unwise decision by some one may result in financial ruin for all others. In case a partner desires to leave the firm, this can result in termination of partnership as there is a restriction on transfer of ownership.

(iv) 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. However, the remaining partners can enter into a fresh agreement and continue to run the business.

(v) Lack of public confidence: A partnership firm is not legally required to publish its financial reports or make other related information public. It is, therefore, difficult for any member of the public to ascertain the true financial status of a partnership firm. As a result, the confidence of the public in partnership firms is generally low.