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FORMS OF BUSINESS ORGANISATION

Types of Companies

A company can be either a private or a public company. These two types of companies are discussed in detail in the following paragraphs.

Private Company

A private company means a company which:

(a) restricts the right of members to transfer its shares;

(b) has a minimum of 2 and a maximum of 200 members, excluding the present and past employees;

(c) does not invite public to subscribe to its securities and It is necessary for a private company to use the word private limited after its name. If a private company contravenes any of the aforesaid provisions, it ceases to be a private company and loses all the exemptions and privileges to which it is entitled. The following are some of the privileges of a private limited company as against a public limited company:

1. A private company can be formed by only two members whereas seven people are needed to form a public company.

2. There is no need to issue a prospectus as public is not invited to subscribe to the shares of a private company.

3. Allotment of shares can be done without receiving the minimum subscription. A private limited company can start business as soon as it receives the certificate of incorporation.

4. A private company needs to have only two directors as against the minimum of three directors in the case of a public company. However the maximum number of directors for both types of companies is fifteen.

5. A private company is not required to keep an index of members while the same is necessary in the case of a public company. Public Company A public company means a company which is not a private company. As per The Companies Act, a public company is one which:

(a) has a minimum of 7 members and no limit on maximum members;

(b) has no restriction on transfer securities; and

(c) is not prohibited from inviting the public to subscribe to its securities. However, a private company which is a subsidiary of a public company is also treated as a public company.

CHOICE OF FORM OF BUSINESS ORGANISATION

After studying various forms of business organisations, it is evident that each form has certain advantages as well as disadvantages. It, therefore, becomes vital that certain basic considerations are kept in mind while choosing an appropriate form of organisation. The important factors determining the choice of organisation are listed in Table 2.4 and are discussed as follows:

(i) Cost and ease in setting up the organisation: As far as initial business setting-up costs are concerned, sole proprietorship is the most inexpensive way of starting a business. However, the legal requirements are minimum and the scale of operations is small. In case of partnership also, the advantage of less legal formalities and lower cost is there because of limited scale of operations. Cooperative societies and companies have to be compulsorily registered. Formation of a company involves a lengthy and expensive legal procedure. From the point of view of initial cost, therefore, sole proprietorship is the preferred form as it involves least expenditure. Company form of organisation, on the other hand, is more complex and involves greater costs.

(ii) Liability: In case of sole proprietorship and partnership firms, the liability of the owners/partners is unlimited. This may call for paying the debt from personal assets of the owners. In joint Hindu family business, only the karta has unlimited liability. In cooperative societies and companies, however, liability is limited and creditors can force payment of their claims only to the extent of the company’s assets. Hence, from the point of view of investors, the company form of organisation is more suitable as the risk involved is limited.

(iii) Continuity: The continuity of sole proprietorship and partnership firms is affected by such events as death, insolvency or insanity of the owners. However, such factors do not affect the continuity of business in the case of organizations like joint Hindu family business, cooperative societies and companies. In case the business needs a permanent structure, company form is more suitable. For short term ventures, proprietorship or partnership may be preferred.

(iv) Management ability: A sole proprietor may find it difficult to have expertise in all functional areas of management. In other forms of organisations like partnership and company, there is no such problem. Division of work among the members in such organisations allows the managers to specialise in specific areas, leading to better decision making. But this may lead to situations of conflicts because of differences of opinion amongst people. Further, if the organisation's operations are complex in nature and require professionalised management, company form of organisation is a better alternative. Proprietorship or partnership may be suitable, where simplicity of operations allow even people with limited skills to run the business. Thus, the nature of operations and the need for professionalised management affect the choice of the form of organisation.

(v) Capital considerations: Companies are in a better position to collect large amounts of capital by issuing shares to a large number of investors. Partnership firms also have the advantage of combined resources of all partners. But the resources of a sole proprietor are limited. Thus, if the scale of operations is large, company form may be suitable whereas for medium and small sized business one can opt for partnership or sole proprietorship. Further, from the point of view of expansion, a company is more suitable because of its capability to raise more funds and invest in expansion plans. It is precisely for this purpose that in our opening case Neha's father suggested she should consider switching over to the company form of organisation.

(vi) Degree of control: If direct control over operations and absolute decision making power is required, proprietorship may be preferred. But if the owners do not mind sharing control and decision making, partnership or company form of organisation can be adopted. The added advantage in the case of company form of organisation is that there is complete separation of ownership and management and it is professionals who are appointed to independently manage the affairs of a company.

(vii) Nature of business: If direct personal contact is needed with the customers such as in the case of a grocery store, proprietorship may be more suitable. For large manufacturing units, however, when direct personal contact with the customer is not required, the company form of organisation may be adopted. Similarly, in cases where services of a professional nature are required, partnership form is much more suitable. It would not be out of place to mention here that the factors stated above are inter-related. Factors like capital contribution and risk vary with the size and nature of business, and hence a form of business organisation that is suitable from the point of view of the risks for a given business when run on a small scale might not be appropriate when the same business is carried on a large scale. It is, therefore, suggested that all the relevant factors must be taken into consideration while making a decision with respect to the form of organisation that should be adopted.

Table 2.4 Factors influencing the choice of form of Business Organisation

Form of organisation		
Factor	**Most advantageous**	**Least advantageous**
Availability of capital	Company	Sole proprietorship
Cost of formation	Sole proprietorship	Company
Ease of formation	Sole proprietorship	Company
Transfer of ownership	Company (except private company)	Partnership
Managerial skills	Company	Sole proprietorship
Regulations	Sole proprietorship	Company
Flexibility	Sole proprietorship	Company
Continuity	Company	Sole proprietorship
Liability	Company	Sole proprietorship

Table 2.5 Comparative Evaluation of Forms of Organisation

Basis of comparison	Sole proprietorship	Partnership	Joint Hindu family business	Cooperative society	Company
Formation	Minimal legal formalities, easiest formation	Registration is optional, easy formation	Less legal formalities, exemption from registration, easy formation	Registration compulsory, greater legal formalities	Registration compulsory, lengthy and expensive formation process
Members	Only owner	Minimum-2 Maximum: 50	At least two persons for division of family property, no maximum limit	At least 10 adults, no maximum limit	Minimum Private-2 Public Company-7 Maximum Private Company-200 Public Company-unlimited
Capital contribution	Limited finance	Limited but more than that can be raised in case of sole proprietorship	Ancestral property	Limited	Large financial resources
Liability	Unlimited	Unlimited and joint	Unlimited *(Karta)*, Limited (Other members)	Limited	Limited
Control and management	Owner takes all decisions, quick decision making	Partners take decisions, consent of all partners is needed	Karta takes decisions	Elected representative, i.e., managing committee takes decisions	Separation between ownership and management
Continuity	Unstable, business and owner regarded as one	More stable but affected by status of partners	Stable business, continues even if *karta* dies	Stable because of separate legal status	Stable because of separate legal status