

As per CBSE Revised Syllabus for 2021 Exam



Chapter 2

Forms of Business Organisation

Revised CBSE Syllabus for 2021 Examination

- ❑ Sole Proprietorship-Concept, merits and limitations.
- ❑ Partnership-Concept, types, merits and limitation of partnership, registration of a partnership firm, partnership deed. Types of partners
- ❑ Hindu Undivided Family Business: Concept
- ❑ Cooperative Societies-Concept, types, merits, and limitations.

- ❑ Company - Concept, merits and limitations;
Types: Private, Public and One Person
Company – Concept
- ❑ Formation of company - stages, important documents to be used in the formation of a company

Sole Proprietorship – Concept, Merits and Limitations

Do you often go in the evenings to buy registers, pens, chart papers, etc., from a small neighbourhood stationery store? Well, in all probability in the course of your transactions, you have interacted with a sole proprietor.

Sole proprietorship is a popular form of business organisation and is the most suitable form for small businesses, especially in their initial years of operation.

Meaning

Sole proprietorship refers to a form of business organisation which is owned, managed and controlled by an individual who is the recipient of all profits and bearer of all risks.

This form of business is particularly common in areas of personalised services such as beauty parlours, hair saloons and small scale activities like running a retail shop in a locality.

It requires less amount of capital. It is best suited for businesses which are carried out on a small scale and where customers demand personalised services.

Definitions of Financial Management

- ❖ “Sole trader is a type of business unit where a person is solely responsible for providing the capital, for bearing the risk of the enterprise and for the management of business.”

—J.L. Hansen

- ❖ “The individual proprietorship is the form of business organisation at the head of which stands an individual as one who is responsible, who directs its operations and who alone runs the risk of failure.”

—L.H. Haney

Features

Salient characteristics of the sole proprietorship form of organisation are as follows:

1. Formation and closure

There is no separate law that governs sole proprietorship. Hardly any legal formalities are required to start a sole proprietary business, though in some cases one may require a license.

Closure of the business can also be done easily. Thus, there is ease in her personal property to repay the firm's debts.

2. Unlimited liability

Sole proprietors have unlimited liability. This implies that the owner is personally responsible for payment of debts in case the assets of the business are not sufficient to meet all the debts. As such the owner's personal possessions such as his/her personal car and other assets could be sold for repaying the debt.

For example, suppose the total outside liabilities of ABC dry cleaner, a sole proprietorship firm, are ₹6,00,000 at the time of dissolution, but its assets are ₹4,00,000 only. In such a situation the proprietor will have to bring in ₹2,00,000 from his/her personal sources even if (s)he has to sell his/her personal property to repay the firm's debts.

3. Sole risk bearer and profit recipient

The risk of failure of business is borne all alone by the sole proprietor. However, if the business is successful, the proprietor enjoys all the benefits. He receives all the business profits which become a direct reward for his risk bearing.

4. Control

The right to run the business and make all decisions lies absolutely with the sole proprietor. He can carry out his plans without any interference from others.

5. No separate entity

In the eyes of the law, no distinction is made between the sole trader and his business, as business does not have an identity separate from the owner. The owner is, therefore, held responsible for all the activities of the business.

6. Lack of business continuity

The sole proprietorship business is owned and controlled by one person. Therefore death, insanity, imprisonment, physical ailment or bankruptcy of the sole proprietor will have a direct and detrimental effect on the business and may even cause closure of the business.

Merits and Limitations of Sole Proprietorship

Merits	Limitations
<p>1. Quick decision making: A sole proprietor enjoys considerable degree of freedom in making business decisions. Decision making is prompt because there is no need to consult others. This may lead to timely capitalisation of market opportunities as and when they arise.</p>	<p>1. Limited resources: Resources of a sole proprietor are limited to his/her personal savings and borrowings from others. Banks and other lending institutions may hesitate to extend a long term loan to a sole proprietor. Lack of resources is one of the major reasons why the size of the business rarely grows much and generally remains small.</p>
<p>2. Confidentiality of information: A sole proprietor can keep all business information confidential and maintain secrecy. He is not bound by law to publish the accounts of his business.</p>	<p>2. Limited life of a business concern: The sole proprietorship business is owned and controlled by one person, so death, insanity, imprisonment, physical ailment or bankruptcy of a proprietor affects the business and can lead to its closure.</p>

3. **Ease of formation and closure:** An important merit of sole proprietorship is the possibility of entering into business with minimal legal formalities. There is no separate law that governs sole proprietorship. As sole proprietorship is the least regulated form of business, it is easy to start and close the business as per the wish of the owner.

4. **Direct incentive:** A sole proprietor directly gets the benefits of his efforts as he is the sole recipient of all the profits. The need to share profits does not arise as he is the single owner. This provides maximum incentive to the sole trader to work hard.

5. **Sense of accomplishment:** There is a personal satisfaction involved in working for oneself. If the business is successful, it contributes to self-satisfaction of the sole proprietor and creates a sense of accomplishment in him.

3. **Unlimited liability:** A major disadvantage of sole proprietorship is that the owner has unlimited liability. If the business fails, the creditors can recover their dues not merely from the business assets, but also from the personal assets of the proprietor. A poor decision or an unfavourable circumstance can create serious financial burden on the owner. That is why a sole proprietor is less inclined to take risks in the form of innovation or expansion.

4. **Limited managerial ability:** The owner has to assume the responsibility of varied managerial tasks such as purchasing, selling, financing, etc. It is rare to find an individual who excels in all these areas. Thus decision making may not be balanced in all the cases. Also, due to limited resources, sole proprietor may not be able to employ and retain talented and ambitious employees.

Hindu Undivided Family

Business/Joint Hindu Family Business

Joint Hindu family business is a specific form of business organisation found only in India. It is one of the oldest forms of business organisation in the country.

Joint Hindu family business refers to a form of organisation wherein the business is owned and carried on by the members of the Hindu Undivided Family (HUF).

It is governed by the Hindu Law. The basis of membership in the business is birth in a particular family and three successive generations can be members in the business.

The business is controlled by the head of the family who is the eldest member and is called **karta**.

All members have equal ownership right over the property of an ancestor and they are known as **co-parceners**.



Note

The Joint Hindu Family Business is on the decline because of the diminishing number of joint Hindu families in the country.

Features

1. Formation

For a joint Hindu family business, there should be at least two members in the family and ancestral property to be inherited by them. The business does not require any agreement as membership is by birth. It is governed by the Hindu Succession Act, 1956.

2. Liability

The liability of all members except the karta is limited to their share of co-parcenary property of the business. The karta, however, has unlimited liability.

3. Control

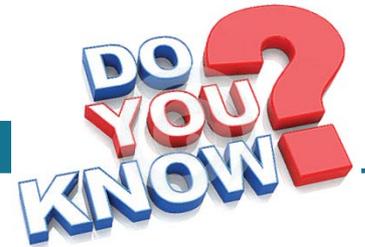
The control of the family business lies with the karta. He takes all the decisions and is authorised to manage the business. His decisions are binding on the other members.

4. Continuity

The business continues even after the death of the karta as the next eldest member takes up the position of karta, leaving the business stable. The business can, however, be terminated with the mutual consent of the members.

5. Minor Members

The inclusion of an individual into the business occurs due to birth in a Hindu Undivided Family. Hence, minors can also be members of the business.



Gender Equality in the Joint Hindu Family – a Reality

According to the Hindu Succession (Amendment) Act, 2005, the daughter of a coparcener of a Joint Hindu Family shall, by birth, become a coparcener. At the time of partition of such a 'Joint Hindu Family' the coparcenary property shall be equally divided to all the coparceners irrespective of their gender (male or female). The eldest member (male or female) of 'Joint Hindu Family' shall become Karta. Married daughter has equal rights in property of a Joint Hindu Family.

Cooperative Societies – Concept, Merits, Limitations and Types

The word 'cooperative' means working together and with others for a common purpose.

The cooperative society is a voluntary association of persons, who join together with the motive of welfare of the members.

- They are driven by the need to protect their economic interests in the face of possible exploitation at the hands of middlemen obsessed with the desire to earn greater profits.
- The cooperative society is compulsorily required to be registered under the Cooperative Societies Act 1912.

- The process of setting up a cooperative society is simple enough and at the most what is required is the consent of at least ten adult persons to form a society.
- The capital of a society is raised from its members through issue of shares.
- The society acquires a distinct legal identity after its registration.

Definitions of Financial Management

- ❖ “Cooperative organisation is “a society which has its objectives for the promotion of economic interests of its members in accordance with cooperative principles.”
—**The Indian Cooperative Societies Act, 1912**
- ❖ “Cooperative is a form of organisation wherein persons voluntarily associate together as human beings on the basis of equality for the promotion of an economic interest for themselves.”
—**E.H. Calvert**

Features

1. Voluntary membership

The membership of a cooperative society is voluntary. Membership is open to all, irrespective of their religion, caste, and gender.

A person is free to join a cooperative society, and can also leave anytime as per his desire. There cannot be any compulsion for him to join or quit a society.

Although procedurally a member is required to serve a notice before leaving the society, there is no compulsion to remain a member.

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Although procedurally a member is required to serve a notice before leaving the society, there is no compulsion to remain a member.

2. Legal status

Registration of a cooperative society is compulsory. Therefore, it is a separate legal entity distinct from its members. The society can enter into contracts and hold property in its name, sue and be sued by others. As a result of being a separate legal entity, it is not affected by the entry or exit of its members.

3. Limited liability

The liability of the members of a cooperative society is limited to the extent of the amount contributed by them as capital. This defines the maximum risk that a member can be asked to bear.

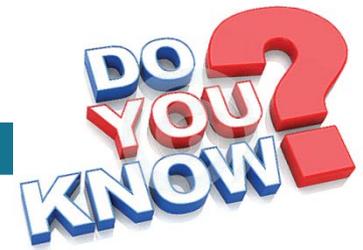
4. Control

In a cooperative society, the power to take decisions lies in the hands of an elected managing committee. The right to vote gives the members a chance to choose the members who will constitute the managing committee and this lends the cooperative society a democratic character.

5. Service motive

The purpose of a cooperative society is mutual help and welfare. It is formed with the motive of service to its members, not to earn profits.

If any surplus is generated as a result of its operations, it is distributed amongst the members as dividend in conformity with the byelaws of the society.



Amul's amazing Cooperative ventures!

Every day Amul collects 4,47,000 litres of milk from 2.12 million farmers (many illiterate), converts the milk into branded, packaged products, and delivers goods worth ` 6 crore (` 60 million) to over 5,00,000 retail outlets across the country. It all started in December 1946 with a group of farmers keen to free themselves from intermediaries, gain access to markets and thereby ensure maximum returns for their efforts. Based in the village of Anand, the Khera District Milk Cooperative Union (better known as Amul) expanded exponentially. It joined hands with other milk cooperatives, and the Gujarat network now covers 2.12 million farmers, 10,411 village level milk collection centres and fourteen district level plants (unions). Amul is the common brand for most product categories produced by various unions: liquid milk, milk powder, butter, ghee, cheese, cocoa products, sweets, ice-cream and condensed milk. Amul's sub-brands include variants such as Amulspray, Amulspree, Amulya and Nutramul.

Merits and Limitations of Cooperative Societies

Merits	Limitations
<p>1. Ease of formation: The cooperative society can be started with a minimum of ten members. The registration procedure is simple involving a few legal formalities. Its formation is governed by the provisions of Cooperative Societies Act 1912.</p>	<p>1. Limited resources: Resources of a cooperative society consists of capital contributions of the members with limited means. The low rate of dividend offered on investment also acts as a deterrent in attracting membership or more capital from the members.</p>
<p>2. Equality in voting status: The principle of 'one man one vote' governs the cooperative society. Irrespective of the amount of capital contribution by a member, each member is entitled to equal voting rights.</p>	<p>2. Inefficiency in management: The members who offer honorary services on a voluntary basis are generally not professionally equipped to handle the management functions effectively.</p>

Cooperative societies are unable to attract and employ expert managers because of their inability to pay them high salaries.

3. **Limited liability:** The liability of members of a cooperative society is limited to the extent of their capital contribution. The personal assets of the members are, therefore, safe from being used to repay business debts.

3. **Lack of secrecy:** As a result of open discussions in the meetings of members as well as disclosure obligations as per the Societies Act (7), it is difficult to maintain secrecy about the operations of a cooperative society.

4. **Stable existence:** Death, bankruptcy or insanity of the members do not affect continuity of a cooperative society. A society, therefore, operates unaffected by any change in the membership.

4. **Government control:** In return of the privileges offered by the government, cooperative societies have to comply with several rules and regulations related to auditing of departments also negative accounts, submission of accounts, etc. Interference in the functioning of the cooperative organisation through the control exercised by the state cooperatively affects its freedom of operation.

5. **Economy in operations:** The members generally offer honorary services to the society. As the focus is

on elimination of middlemen, this helps in reducing costs.

6. Support from government: The cooperative society exemplifies the idea of democracy and hence finds support from the Government in the form of low taxes, subsidies, and low interest rates on loans.

5. Differences of opinion: Internal quarrels arising as a result of contrary viewpoints may lead to difficulties in decision making. Personal interests may start to dominate the welfare motive and the benefit of other members may take a backseat if personal gain is given preference by certain members.

Types of Cooperative Societies– A Comparison

Basis	Consumer's cooperative societies	Producer's cooperative societies	Marketing cooperative societies	Farmer's cooperative societies	Credit cooperative societies	Cooperative housing societies
Established	The consumer cooperative societies are formed to protect the interests of consumers.	These societies are set up to protect the interest of small producers.	Such societies are established to help small producers in selling their products.	These societies are established to protect the interests of farmers by providing better inputs at a reasonable cost.	Credit cooperative societies are established for providing easy credit on reasonable terms to the members.	Cooperative housing societies are established to help people with limited income to construct houses at reasonable costs.
Members	The members comprise of consumers desirous of obtaining good quality products at reasonable prices.	The members comprise of producers desirous of procuring inputs for production of goods to meet the demands of consumers.	The members consist of producers who wish to obtain reasonable prices for their output.	The members comprise farmers who wish to jointly take up farming activities.	The members comprise of persons who seek financial help in the form of loans.	The members of these societies consist of people who are desirous of procuring residential accommodation at lower costs.

Aim	The society aims at eliminating middlemen to achieve economy in operations.	The society aims to fight against the big capitalists and enhance the bargaining power of the small producers.	The society aims to eliminate middlemen and improve competitive position of its members by securing a favourable market for the products.	The aim is to gain the benefits of large scale farming and increase the productivity.	The aim of such societies is to protect the members from the exploitation of lenders who charge high rates of interest on loans.	The aim is to solve the housing problems of the members by constructing houses and giving the option of paying in instalments.
Functioning	It purchases goods in bulk directly from the wholesalers and sells goods to the members, thereby eliminating the middlemen. Profits, if any, are distributed on the basis of either their capital contributions to the society or purchases made by individual members.	It supplies raw materials, equipment and other inputs to the members and also buys their output for sale. Profits among the members are generally distributed on the basis of their contributions to the total pool of goods produced or sold by the society.	It pools the output of individual members and performs marketing functions like transportation, warehousing, packaging, etc., to sell the output at the best possible price. Profits are distributed according to each member's contribution to the pool of output.	Such societies provide better quality seeds, fertilisers, machinery and other modern techniques for use in the cultivation of crops. This helps not only in improving the yield and returns to the farmers, but also solves the problems associated with the farming on fragmented land holdings.	Such societies provide loans to members out of the amounts collected as capital and deposits from the members and charge low rates of interest.	These societies construct flats or provide plots to members on which the members themselves can construct the houses as per their choice.

Objective Type Questions 2.1

Question 1

A sole proprietor has

(Choose the correct alternative)

- (a) Limited liability
- (b) Unlimited liability
- (c) No liability for debts
- (d) Joint liability



Answer 1

(b) Unlimited liability



Question 2

The Karta in Joint Hindu Family Business has

(Choose the correct alternative)

- (a) Limited liability
- (b) Unlimited liability
- (c) No liability for debts
- (d) Joint liability



Answer 2

(b) Unlimited liability



Question 3

The Head of the Hindu undivided Family Business is called *(Choose the correct alternative)*

- (a) Proprietor
- (b) Director
- (c) Karta
- (d) Manager



Answer 3

(c) Karta



Question 4

In a cooperative society, the principle followed is

(Choose the correct alternative)

- (a) One share one vote
- (b) One man one vote
- (c) No vote
- (d) Multiple votes



Answer 4

(b) One man one vote



Question 5

The minimum number of members in a cooperative society is *(Choose the correct alternative)*

- (a) 2
- (b) 3
- (c) 7
- (d) 10



Answer 5

(d) 10



Question 6

The liability of a sole trader is limited to the extent of capital introduced by him into the business.

True/False? Give reason.



Answer 6

False: A sole trader has unlimited liability. In the case of business losses, if the business assets are not sufficient to meet all business liabilities, he may have to sell his personal property to pay off the liabilities.



Question 7

The sole proprietorship concern sinks or swims with its proprietor. *True/False? Give reason.*



Answer 7

False: If there are losses, he alone has to bear them. If there is profit, he is its sole recipient.



Question 8

Sole proprietorship is more suitable for large-scale business.
True/False? Give reason.



Answer 8

False: Sole proprietorship is suitable for businesses which are carried out on a small scale with modest capital, e.g., grocery store.



Question 9

A Joint Hindu Family Business is based on a contract between co-parceners. *True/False? Give reason.*



Answer 9

False: It is not based on any contract between members. There must be at least two members and an ancestral property for a Joint Hindu Family Business. Membership is by birth.



Question 10

There is no limit to the number of members in a Joint Hindu Family Business. *True/False? Give reason.*



Answer 10

False: Since membership is by birth, minors can also be its members. However, only three successive generations can be members in the business.



Question 11

Death or insanity of a member of the Joint Hindu Family Business will bring its business to an end.

True/False? Give reason.



Answer 11

False: The business continues even after the death of Karta as the next oldest member takes up the position of Karta. The business is stable.



Question 12

Registration of a cooperative society is not compulsory.
True/False? Give reason.



Answer 12

False: A cooperative society is compulsorily required to be registered under the Cooperative Societies Act, 1912.



Question 13

Cooperative societies are established with profit motive.
True/False? Give reason.



Answer 13

False: The purpose of a cooperative society is mutual help and welfare. It is formed with the motive of service to its members, not to earn profits.



Question 14

Is a sole proprietor bound to publish his/her businesses accounts?



Answer 14

No, he/she can keep all business information confidential.



Question 15

What are the different options to expand sole proprietorship business?



Answer 15

The two options for sole proprietorship firm to expand are:

- (i) Appointment of salaried manager/ assistant.
- (ii) Admit a partner.



Question 16

Name the form of business organisation found only in India.



Answer 16

Joint Hindu Family Business.



Question 17

Name the person who manages a Joint Hindu Family Business.



Answer 17

Karta.



Question 19

How many members must be there in a joint family to carry on Joint Hindu Family Business?



Answer 19

Minimum two members.



Question 20

What is the liability of Karta in Joint Hindu Family Business?



Answer 20

Unlimited liability.



Question 21

Who are co-parceners?



Answer 21

Co-parceners are the members of the Joint Hindu Family Business other than Karta.



Question 22

What is the basis of membership in the Joint Hindu Family Business?



Answer 22

Basis of membership is birth in a particular family.



Question 23

What happens to Joint Hindu Family Business if Karta or any other member dies?



Answer 23

Business continues.



Question 24

What is the main cause of decline in Joint Hindu Family Business?



Answer 24

Diminishing number of Joint Hindu families.



Question 25

What is the minimum number of persons required to form a cooperative society?



Answer 25

Ten adult persons.



Question 26

Is registration of a cooperative society compulsory?



Answer 26

Yes, registration of a cooperative society is compulsory under the Cooperative Societies Act, 1912.



Question 27

Name the type of cooperative society set up to protect the interest of small producers.



Answer 27

Producers' cooperative societies



Question 28

Name the cooperative society set up to protect the interests of farmers.



Answer 28

Farmers' cooperative societies



Question 29

Name the cooperative society set up to make residential accommodation available to its members at lower costs.



Answer 29

Cooperative housing society



Question 30

Which form of business is suitable for a tailoring shop?



Answer 30

Sole proprietorship because personal attention is required.



Question 31

Which form of organisation is considered to be the simplest form of organisation?



Answer 31

Sole proprietorship.



Question 32

Mention any two businesses sole proprietorship would be suitable form of business.



Answer 32

- (i) Beauty parlour
- (ii) Grocery store



Question 33

Which is the least regulated form of business?



Answer 33

Sole proprietorship.



Question 34

Name the form of business organisation in which a minor can be full-fledged member.



Answer 34

Joint Hindu Family Business.



Question 35

Who controls the Joint Hindu Family Business?



Answer 35

Karta, generally the eldest member of the family.



Question 36

Name the form of business organisation which is formed with the motive of welfare of the members.



Answer 36

Cooperative society.



Question 37

Name the type of cooperative society set up to protect the interests of consumers.



Answer 37

Consumers' cooperative societies.



Question 38

“Working for oneself provides personal satisfaction.”
Which merit of sole proprietorship is highlighted in this statement?



Answer 38

Sense of accomplishment.



Question 39

“The control of the business lies with the eldest member of the family.” To which form of business organisation is this applicable?



Answer 39

Joint Hindu Family Business.



Question 40

“Employees Union of Hindustan Textiles start a retail store to make daily household articles at reasonable prices available to its members.” Identify this form of business organisation.



Answer 40

Cooperative society (Consumers' cooperative society).



Question 41

Teachers of various schools in South Delhi form a society to buy land and construct flats for its members. Identify this form of business organisation.



Answer 41

Cooperative society (Cooperative housing society).



Question 42

Name the type of cooperative society set up to help the small producers in selling their products.



Answer 42

Marketing cooperative society.



Question 43

Name the cooperative society set up to provide easy credit on reasonable terms to the members.



Answer 43

Credit cooperative society



Case Studies 2.1

Question 1

Radhika Priya Dasi opened a boutique along with four workers. No problem of any type was faced in opening the boutique. At her boutique special dresses made for marriages and parties are sold. Despite there being a lot of competition in the market, the boutique was earning a good profit. Since all the profit went into her pocket, Radhika Priya Dasi was getting inspired to work with great efficiency. With the increase in workload, the number of workers was increased from 4 to 6 by her.

All of them were happy since the business was running successfully. Unfortunately, one day the boutique caught fire due to a short circuit. Consequently, Radhika Priya Dasi had to suffer a heavy loss. The circumstances deteriorated so much that she had to dispose off her personal properties to repay the boutique's debts. In order to revive the boutique, she approached a bank which did not extend a long-term loan to her.

- (a) Identify the form of business organisation discussed in the above para.
- (b) Explain any three merits of the form of business



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- (b) Explain any three merits of the form of business organisation identified in (a) by quoting the lines from the above para.
- (c) Also explain any two limitations of the form of business organisation identified in (a) by quoting the lines from the above para. **(6 marks)**

Answer 1

(a) The form of business organisation of Radhika Priya Dasi's boutique is 'Sole Proprietorship'.

(b) MERITS OF SOLE PROPRIETORSHIP :

(i) Ease of formation

“No problem of any type was faced in opening the boutique.”

Hardly any legal formalities are required to start a sole proprietary business.

(ii) Direct incentive

“Since all the profit went into her pocket, Radhika Priya Dasi was getting inspired to work with great efficiency.”

A sole proprietor directly gets the benefits of his efforts as he is the sole recipient of all the profits.

(iii) Flexibility of operations

“With the increase in workload, the number of workers was increased from 4 to 6 by her.”

In a proprietorship business, all decisions are taken by a single person. There are no delays and the business can quickly adapt itself to the changing environment. This provides flexibility to the business.

LIMITATIONS OF SOLE PROPRIETORSHIP :

(i) Unlimited liability

“The circumstances deteriorated so much that she had to dispose off her personal properties to repay the boutique’s debts.”

Sole proprietors have unlimited liability. In the case of business losses, if the business assets are not sufficient to meet all business liabilities, the proprietor may have to sell his personal property to pay off the liabilities.

(ii) Limited resources

“In order to revive the boutique, she approached a bank which did not extend a long-term loan to her.”

Resources of a sole proprietor are limited to his/her personal savings and borrowings from others. Banks and other lending institutions may hesitate to extend a long-term loan to a sole proprietor.

Question 2

Gopal Sharma and Balram Sharma are two brothers, who inherited some ancestral property. They decided to form a Hindu Undivided Family (HUF) business consisting of four male members. Gopal Sharma is the elder brother. So he became 'Karta'. The business took a loan of ` 20 lakh from Punjab National Bank having maturity period of 5 years. Due to poor financial position of the business, they were unable to repay the loan. They sold the ancestral property for ` 10 lakh and paid the same to Punjab National Bank. They could not pay the balance amount of loan with interest. The bank

filed a case for recovery of the balance amount. Gopal Sharma pleaded the court that the loan was taken for the purpose of business, therefore, all the members of the business were liable to repay the loan. The court held that all other members were responsible only to the extent of their share in business, and the business property was already sold. However, Gopal Sharma, being 'Karta' would have to repay the balance amount even by selling his personal properties. Gopal Sharma had to sell some of his personal assets to repay the balance amount of bank loan.

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- (a) Is the court's decision justified? Give reasons in support of your answer.
- (b) State any three other features of HUF businesses.
(4 marks)

Answer 2

- (a) Yes, the court's decision is justified because in a Hindu Undivided Family (HUF) business, 'Karta' has unlimited liability, whereas the liability of all other members is limited to their share in the property of the business.
- (b) FEATURES :
- (i) **Membership by Birth:** Membership of the Joint Hindu Family Business is automatic by birth.
- (ii) **No Maximum Limit:** There is no restriction on the number of co-parceners of the HUF business. However, only three successive generations can be members in the

business.

- (iii) **Formation:** There should be at least two members and ancestral property to form a Joint Hindu Family Business. It is not created by an agreement between persons.

Question 3

A group of people in a locality of Delhi used to go for a walk in the morning. After the walk, they would often sit together and discuss the subjects like Politics, Demonetisation, Elections, Market prices of different goods, etc. There were about fifty persons in this group. One day, instead of other subjects, their focus of discussion was 'Market Prices of Different Goods'. During the discussion, the emphasis laid on the point was that goods become very costly by the time they reach the consumers after getting transported from the producers. Consequently, everyone's budget is getting disturbed.

To get rid of this problem some people suggested that they should join together to form a society. The society would sell the goods to all the members as per their requirements after buying them in a large quantity directly from the producers. This suggestion was appreciated by all of them. They all became members of the society and encouraged other people also to become its members. In no time, 100 members assembled and the society was formed.

The idea of forming the society immediately proved to be successful. Now their budget became balanced. A special characteristic of this society was that apart from its



members it also sold goods to the other people of the society at cheaper rates. All of them were very happy with

(a) Identify and explain the type of the society formed by them.

(b) Under what Act, the society must have been formed?

(c) What is the liability of the members of the society so formed?

(d) Explain any two merits of the society so formed.

(6 marks)



Answer 3

(a) Consumers' Cooperative Society

Its purpose is to protect the interests of consumers. Consumers desirous of obtaining good quality products at reasonable prices become its members. It purchases goods in bulk directly from the wholesalers and sells goods to the members.

(b) The Cooperative Societies Act, 1912

(c) Limited Liability

The liability of the members of a cooperative society is limited to the extent of the amount contributed by them as capital.



The personal assets of the members are safe from being used to repay business debts.

MERITS OF COOPERATIVE SOCIETY

- (i) Ease of formation: Any ten adult persons can form a cooperative society. The registration procedure is simple involving a few legal formalities.
- (ii) Stable existence: It is a separate legal entity distinct from its members. Death, bankruptcy or insanity of the members do not affect its continuity.

(iii) Support from government: Government gives all kind of support to cooperative societies in the form of relief in taxation, subsidies and low interest rates on loans. *(any two)*

Question 4

Shonali Sharma, after completing her MBA, began to help her father, Mr. Shiv Sharma, in his business. The business had a limited capital investment. Shonali wanted to use the modern business techniques in every area of business, namely, purchase, sales, production, finance, etc. In fact, she wanted to implement the methods, which she had learnt in her MBA course, in her father's business. As soon as she started adopting the latest techniques, the workers began to protest and resist the changes. So she became disappointed and left her father's business. She started working in an MNC. Mr.

Shiv Sharma was unable to assume the responsibility of all managerial tasks such as purchasing, selling, financing, etc. Good workers started leaving the organisation. The goodwill of the business in the market went on declining. In no time, the liabilities of the business became many times more than the assets. On account of the pressure exerted on him by the creditors, Mr. Shiv Sharma had to repay the debts of the business by disposing off his personal properties.

- (a) Identify the form of business organisation discussed in the above para.

(b) Quoting the relevant lines from the para explain any three limitations of the form of business organisation identified in (a). **(4 marks)**

Answer 4

- (a) Sole proprietorship
- (b) LIMITATIONS OF SOLE PROPRIETORSHIP

- (i) Limited resources

“The business had a limited capital investment.”

Resources of a sole proprietor are limited to his/her personal savings and borrowings from others. Banks and other lending institutions may hesitate to extend a long-term loan to a sole proprietor.

- (ii) Limited managerial ability

“Mr. Shiv Sharma was unable to assume the responsibility



of all managerial tasks such as purchasing, selling, financing, etc. Good workers started leaving the organisation.”

The owner has to assume the responsibility of all managerial tasks such as purchasing, selling, financing, etc. Due to limited resources, he may not be able to employ talented employees.

(iii) Unlimited liability

“ Mr. Shiv Sharma had to the debts of the business by disposing off his personal properties.”

Sole proprietors have unlimited liability. In the case of business losses, if the business assets are not sufficient to meet all business liabilities, the proprietor may have to sell his personal property to pay off the liabilities.

Question 5

Rajeev Lochan Das is the only owner of a shirt manufacturing factory. He took a loan of ₹ 20 lakh from a finance company for expansion of his business. In the beginning his business was running well but later on he started incurring losses and due to continuous losses he was not able to repay the loan. After receiving many reminders from the finance company, Rajeev planned to close the business. He sold all his machines and other asset He requested the finance company to settle the accounts at ₹ 15 lakh. But the finance company refused, and on his failure to pay the total debt, it filed a case

against him in the court.s and realised ₹ 15 lakh. Rajeev gave an argument in the court that he had sold all his business assets, and the loan was taken by him for business, not for his personal use. So the finance company must settle the account at ₹ 15 lakh. The court did not agree with the argument of Rajeev and gave the decision in favour of the finance company. He was ordered to pay full amount of loan by selling off his personal assets.

- (a) Identify the form of business carried on by Rajeev Lochan Das.

-
- (b) State the feature of the form of business identified in (a) which is considered by the court while giving the judgement.
- (c) State why Rajeev's argument was not correct.

(3 marks)

Answer 5

(a) Sole Proprietorship

(b) Unlimited Liability

Sole proprietors have unlimited liability. In the case of business losses, if the business assets are not sufficient to meet all business liabilities, the proprietor may have to sell his personal property to pay off the liabilities.

(c) Rajeev's argument was not correct because a sole proprietor does not enjoy separate legal entity.



Partnership – Concept, Merits and Limitations

Concept of Partnership

As the business expands, one needs more capital and larger number of people to manage the business and share its risks. In such a situation, people usually adopt the partnership form of organisation.

When two or more persons join hands to set up a business and share its profits and losses, they are said to be in partnership.

Persons who have entered into partnership with one another are individually called '**partners**' and collectively called '**firm**'.

The name under which the business is carried is called the '**firm's name**'.



Partnership– setting up of a business by two or more persons and sharing its profits and losses

Definitions of Financial Management

- ❖ “Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.”

—Section 4 of the Indian Partnership Act, 1932

- ❖ “Partnership is the relation which subsists between persons who have agreed to combine their property, labour or skill in some business and to share the profits therefrom between them.”

—The Indian Contract Act, 1872

Partnership is the relation between persons competent to make contract, who agree to carry on a lawful business in common with a view to private gain.”

—L.H. Haney



Note

A partnership firm has no separate legal entity, apart from the partners constituting it.

Features of Partnership

has to sell his/her personal property to repay the firm's debts.

1. Formation

The partnership form of business organisation is governed by the Indian Partnership Act, 1932.

- Partnership is the result of an agreement between two or more persons to do business and share its profits and losses. The agreement becomes the basis of relationship between the partners. It is not necessary that such agreement is in written form. An oral agreement is equally valid. But in order to avoid disputes, it is preferred that the partners have a written agreement.

The agreement should be to carry on some business. Mere co-ownership of a property does not amount to partnership.

For example, if Harshit and Chirag jointly purchase a plot of land, they become the joint owners of the property and not the partners. But if they are in the business of purchase and sale of land for the purpose of making profit, they will be called partners.

- The agreement between partners must be to share profits and losses of a business. If some persons join hands for the purpose of some charitable activity, it will not be termed as partnership.

2. 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 (miscellaneous) Rules 2014, at present the maximum number of members can be 50.

3. Liability

The partners of a firm have unlimited liability. Personal assets may be used for repaying debts in case the business assets are insufficient to pay business debts. Further, the partners are jointly and individually liable for payment of firm's debts. Jointly, all the partners are responsible for the debts and they contribute in their profit sharing ratio. Individually, each partner can be held responsible to repay the debts of the business. However, such a partner can later recover the balance amount from other partner(s).

For example, A and B are partners of a firm sharing profits and losses equally. The assets of the firm amount to ₹1,00,000 but the firm's debts are ₹ 1,50,000.

Here, A and B are liable to bring ` 25,000 each from their personal property to pay the firm's debts. But if suppose B is insolvent and cannot bring any amount, then A alone will be liable to pay firm's debt of ` 50,000 because of his unlimited liability.

4. 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.

5. 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.

6. 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.

7. Mutual agency

The business of a partnership concern may be carried on by all the partners or any of them acting for all. This statement has two important implications:

- *First*, every partner is entitled to participate in the conduct of the affairs of its business.
- *Second*, that there exists a relationship of mutual agency between all the partners. Each partner carrying on the business is the principal as well as the agent for all the other partners. He can bind other partners by his acts and also is bound by the acts of other partners with regard to business of the firm.

Relationship of mutual agency is so important that one can say that there would be no partnership, if the element of mutual agency is absent.

Merits and Limitations of Partnership

Merits	Limitations
<p>1. Ease of formation and closure: A partnership firm can be formed easily with an agreement between two or more persons to carry some lawful business. Registration is not compulsory. Closure of the firm too is an easy task.</p>	<p>1. Unlimited liability: The partners of a firm have unlimited liability. Personal assets may be used for repaying debts in case the business assets are insufficient to pay business 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.</p>
<p>2. Balanced decision making: Different partners having expertise in different areas of functions can take correct decisions with the consent of all other partners. As a result, decisions are likely to be more balanced.</p>	<p>2. 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.</p>
<p>3. 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.</p>	<p>3. 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.</p>
<p>4. 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.</p>	<p>4. 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.</p>
<p>5. 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.</p>	<p>5. 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.</p>

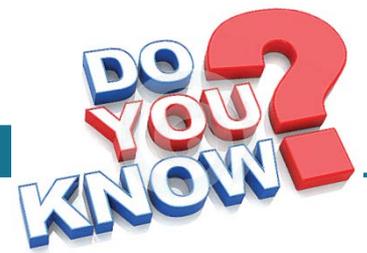
Types of Partnership and Partners

Classification on the basis of duration

	Partnership at will	Particular partnership
Meaning	Partnership formed at the will of the partners is called 'partnership at will'.	Partnership formed for the accomplishment of a particular project say construction of a building or an activity to be carried on for a specified time period is called 'particular partnership'.
Duration	It can continue as long as the partners want and is terminated when any partner gives a notice of withdrawal from partnership to the firm.	It dissolves automatically when the purpose for which it was formed is fulfilled or when the time duration expires.

Classification on the basis of liability

	General Partnership	Limited Partnership
Liability	In general partnership, the liability of partners is unlimited and joint.	In limited partnership, the liability of at least one partner is unlimited whereas the rest may have limited liability.
Participation in Management	The partners enjoy the right to participate in the management of the firm and their acts are binding on each other as well as on the firm.	The limited partners do not enjoy the right of management and their acts do not bind the firm or the other partners.
Registration	Registration of the firm is optional.	Registration of such partnership is compulsory.
Existence	The existence of the firm is affected by the death, lunacy, insolvency or retirement of the partners.	Such a partnership does not get terminated with the death, lunacy or insolvency of the limited partners.



Limited Partnership was not permitted in India earlier. The permission to form partnership firms with limited liability has been granted after introduction of New Small Enterprise Policy in 1991. The idea behind such a move has been to enable the partnership firms to attract equity capital from friends and relatives of small scale entrepreneurs who were earlier reluctant to help, due to the existence of unlimited liability clause in the partnership form of business.

Types of Partners

W	Active Partner	Sleeping or Dormant Partner	Secret Partner	Nominal Partner	Partner by Estoppel
Meaning	An active partner is one who takes actual part in carrying out business of the firm on behalf of other partners.	Partners who do not take part in the day to day activities of the business are called sleeping partners.	A secret partner is one whose association with the firm is unknown to the general public. Contributes to the capital of the firm.	A nominal partner is one who allows the use of his/her name by a firm.	A person is considered a partner by estoppel if, through his/her own initiative, conduct or behaviour, he/she gives an impression to others that he/she is a partner of the firm.
Capital contribution	An active partner contributes capital to the firm.	A sleeping partner contributes capital to the firm.	A secret partner contributes to the capital of the firm.	A nominal partner does not contribute capital.	He/she does not contribute capital to the firm.
Participation in Management	Participates in the management of the firm.	Does not participate in the management of the firm.	Participates in the management of the firm.	Does not take active part in management of the firm.	Does not take part in management of the firm.
Share in Profits/ Losses	Shares profits and losses of the business.	Shares profits and losses of the business.	Shares profits and losses of the business.	Generally does not share profit or losses.	Does not share profit or losses.
Liability	Unlimited liability i.e., personal assets can be used to pay firm's debts.	Unlimited liability towards the creditors of the firm.	Unlimited liability towards the creditors of the firm.	Unlimited liability to the third parties for the repayments of the firm's debts.	Unlimited liability to the third parties for the repayments of the firm's debts.

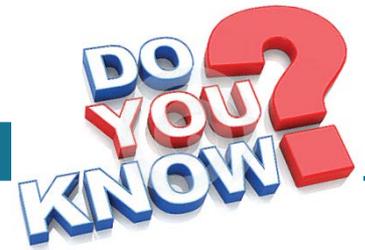


Top Tip

An example of a partner by estoppel

Suppose Abhishek is a friend of Naveen who is a partner in a software firm — Simplex Solutions. On Naveen's request, Abhishek accompanies him to a business meeting with Amit Softwares and actively participates in the negotiation process for a business deal and gives the impression that he is also a partner in Simplex Solutions. If credit is extended to Simplex Solutions on the basis of these negotiations, Abhishek would also be liable for repayment of such debt, as if he is a partner of the firm.

Such partners are held liable for the debts of the firm because in the eyes of the third party they are considered partners, even though they do not contribute capital or take part in its management.



Minor as a Partner

Partnership is based on legal contract between two persons who agree to share the profits or losses of a business carried on by them. As such a minor is incompetent to enter into a valid contract with others, he cannot become a partner in any firm. However, a minor can be admitted to the benefits of a partnership firm with the mutual consent of all other partners. In such cases, his liability will be limited to the extent of the capital contributed by him and in the firm. He will not be eligible to take an active part in the management of the firm. Thus, a minor can share only the profits and can not be asked to bear the losses. However, he can if he wishes, inspect the accounts of the firm.

The status of a minor changes when he attains majority. In fact, on attaining majority, the minor has to decide whether he would like to become a partner in the firm. He has to give a public notice of his decision within six months of attaining majority. If he fails to do so, within the stipulated time, he will be treated as a full-fledged partner and will become liable to the debts of the firm to an unlimited extent, in the same way as other active partners are.

Registration of a Partnership Firm

Registration of a partnership firm means the entering of the firm's name, along with the relevant prescribed particulars, in the Register of firms kept with the Registrar of Firms.

- It provides conclusive proof of the existence of a partnership firm.
- It is optional for a partnership firm to get registered. However, in case a firm does not get registered, it is deprived of many benefits.

Consequences of non-registration of a firm

1. A partner of an unregistered firm cannot file a suit against the firm or other partners,
2. The firm cannot file a suit against third parties, and
3. The firm cannot file a case against the partners.

In view of these consequences, it is therefore advisable to get the firm registered.

Extra Shots

Procedure for Registration of a Partnership Firm

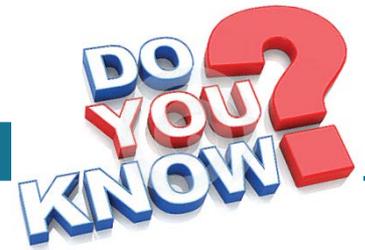
According to the Indian Partnership Act 1932, the partners may get the firm registered with the Registrar of firms of the state in which the firm is situated. The registration can be at the time of formation or at any time during its existence.

The procedure for getting a firm registered is as follows:

1.Submission of application: Submission of application in the prescribed form to the Registrar of firms. The application should contain the following particulars:

- Name of the firm
- Location of the firm
- Names of other places where the firm carries on business
- The date when each partner joined the firm
- Names and addresses of the partners
- Duration of partnership

This application should be signed by all the partners.



Partnership Deed

A partnership is a voluntary association of people who come together for achieving common objectives. In order to enter into partnership, a clear agreement with respect to the terms, conditions and all aspects concerning the partners is essential so that there is no misunderstanding later among the partners.

Such an agreement can be oral or written. Even though it is not essential to have a written agreement, it is advisable to have a written agreement as it constitutes an evidence of the conditions agreed upon.

The written agreement which specifies the terms and conditions that govern the partnership is called the partnership deed.

Clauses/Contents of Partnership Deed

The partnership deed generally includes the following aspects:

- Name of firm
- Nature of business and location of business
- Duration of business
- Capital contribution made by each partner

- Profits and losses sharing ratio between the partners
- Duties and obligations of the partners
- Salaries and withdrawals of the partners
- Terms governing admission, retirement and expulsion of a partner
- Interest on capital and interest on drawings
- Procedure for dissolution of the firm
- Preparation of accounts and their auditing
- Method of solving disputes

Objective Type Questions 2.2

Question 1

Match the Columns:

(i) A person who lends his name and goodwill for the benefits of a partnership firm.	(A) Particular partnership
(ii) A person who contributes capital but does not take part in the business of the firm.	(B) Partnership deed
(iii) A document containing terms and conditions of partnership.	(C) Sleeping partner
(iv) A partnership set up for a specific project.	(D) Nominal partner



Answer 1

(i) – (D), (ii) – (C), (iii) – (B), (iv) – (A)



Question 2

A partner whose association with the firm is unknown to the general public is called

(Choose the correct alternative)

- (a) Active partner
- (b) Sleeping partner
- (c) Nominal partner
- (d) Secret partner



Answer 2

(d) Secret partner



Question 3

It is compulsory to get a partnership firm registered.
True/False? Give reason.



Answer 3

False: Registration of a partnership firm is optional. However, an unregistered firm suffers from many disabilities, e.g., it cannot file a suit against any third party or any partner.



Question 4

The liability of a partner in a partnership firm is limited to the extent of his share. *True/False? Give reason.*



Answer 4

False: A partner has unlimited liability. He may have to sell his personal assets to pay firm's debts.



Question 5

An unregistered firm can not be sued by a third party.
True/False? Give reason.



Answer 5

False: Non-registration of a partnership firm does not affect the right of third parties to file a suit against the firm for their claims.



Question 6

Every partner is both principal and agent of the other partners. *True/False? Give reason.*



Answer 6

True: An agreement made by one partner is binding on other partners if it is made in the name of the firm and is related to the business of the partnership firm.



Question 7

If two dacoits sign an agreement to operate together and share the loot, it is a partnership.

True/False? Give reason.



Answer 7

False: The partnership comes into an agreement among partners to carry on some lawful business with profit motive.



Question 8

A nominal partner is a partner in name only—he incurs no liabilities.

True/False? Give reason.



Answer 8

False: A nominal partner also has unlimited liability to the third parties for the repayment of firm's debts.



Question 9

What is the maximum number of partners in a partnership firm?



Answer 9

Rule 10 of the Companies (Miscellaneous) Rules 2014 provides the maximum limit as 50 partners.



Question 10

Name the form of business organisation in which the members are jointly and individually liable for payment of the firm's debts.



Answer 10

Partnership



Question 11

Name the basic document prepared in partnership firm.



Answer 11

Partnership deed



Question 12

State the law governing the partnership in India.



Answer 12

The Indian Partnership Act, 1932.



Question 13

Why is a written agreement of partnership preferred?



Answer 13

To avoid any dispute among the partners which may arise in future.



Question 14

What is meant by mutual agency in a partnership?



Answer 14

Mutual agency in a partnership means that every partner is both an agent and a principal of other partners for the purpose of carrying on the business.



Question 15

Name the type of partner who contributes capital and shares profits/losses but does not take part in the day-to-day management of the firm.



Answer 15

Sleeping or dormant partner.



Question 16

Name the type of partner who is not really a partner but is liable to third parties for the repayment of the firm's debts.



Answer 16

Nominal partner



Question 17

Name the partner whose association with the firm is not known to the general public.



Answer 17

Secret partner



Question 18

Name the form of business organisation which can be formed by an oral agreement between the members.



Answer 18

Partnership



Question 19

In which form of organisation is a trade agreement made by one owner binding on the others?



Answer 19

Partnership.



Question 20

What is the liability of partners?



Answer 20

Unlimited, i.e., they may have to sell their personal assets to pay firm's debts.



Question 21

Name the form of business organisation in which members are agents and principals of each other.



Answer 21

Partnership



Question 22

Name the type of partnership which is formed to accomplish a specific project for a specified time period.



Answer 22

Particular partnership



Question 23

Name the partner who does not have interest in the partnership business but lends his name to the firm.



Answer 23

Nominal partner



Question 24

“In spite of not being a partner, he becomes liable to third parties for the repayment of the firm’s debts.” By what name such a person is known?



Answer 24

Nominal partner



Question 25

“Arora Brothers is a firm formed for the construction of a shopping mall.” Identify this type of partnership.



Answer 25

Particular partnership



Case Studies 2.2

Question 1

The business assets of an organisation amount to ₹ 50,000 but the debts that remain unpaid are ₹ 80,000. What course of action can the creditors take if:

- (a) the organisation is a sole proprietorship firm
 - (b) the organisation is a partnership firm with Anthony and Akbar as partners, who share profits and losses equally. Which of the two partners can the creditors approach for repayment of debt? Explain giving reasons.
- (4 marks)**

Answer 1

Business assets = ₹50,000; Liabilities = ₹ 80,000

Therefore, Creditor's claim = ₹ 30,000

- (a) If the organisation is a sole proprietorship firm, the creditors can sue the sole proprietor for ₹ 30,000, because a sole proprietor has unlimited liability. In the case of business losses, if the business assets are not sufficient to meet all business liabilities, the proprietor may have to sell his personal property to pay off the liabilities.
- (b) If the organisation is a partnership firm with Anthony and Akbar as partners, the creditors can

sue both the partners or a single partner for their claims. The reason is that partners have unlimited liability. They are jointly and individually liable for payment of firm's debts. Jointly, all the partners are responsible for the payment of the firm's debts in their profit sharing ratio. So, Anthony and Akbar will have to pay ₹ 15,000 each. Individually, a single partner (suppose Anthony) can be held responsible to repay the debts of the business ₹ 30,000, if Akbar becomes insolvent and cannot bring anything from his private assets.

Question 2

The two friends, Soniya and Raman started a business by the name of ‘Soniyo Fancy Dress Shoppy’. Both of them invested equal capital in the business. At the start of the business, Soniya had placed one condition before Raman that if unfortunately they suffered a heavy loss in their business, she would not be able to give anything except the capital invested in the business. Raman had accepted this condition on the terms and condition that Soniya would not enjoy the right to participate in the management of the firm. Their business was gradually growing well and they were fully satisfied with their business.

-
- (a) To what form of business organisation is concerned the above para?
- (b) Identify and explain the type of the form of organisation identified in (a). **(3 marks)**

Answer 2

- (a) Partnership
- (b) Limited Partnership
 - In limited partnership, the liability of at least one partner is unlimited whereas the rest may have limited liability.
 - The limited partners do not enjoy the right of management and their acts do not bind the firm or the other partners.

Question 3

Dhruv, Sarthak and Dheeraj are three partners in a firm. The name of the firm is 'Friends Pustak Bhandar'. The latest books of almost all subjects remain available at the Pustak Bhandar. All the three partners decided that 10% of the total profit of the firm would be distributed among the poor children every year. This has a very positive effect on the goodwill of the firm. Dheeraj is a renowned businessman who allowed the use of his name by the firm but does not contribute capital. Sarthak had contributed capital to the firm but does not participate in the management of the firm. Dhruv actively participates in

the management and does business on behalf of other partners.

Explain what types of partners Dhruv, Sarthak and Dheeraj are in 'Friends Pustak Bhandar'. **(6 marks)**



Answer 3

- (i) Dhruv is an active partner. An active partner is one who contributes capital to the firm and takes actual part in carrying out business of the firm on behalf of other partners. He shares profits and losses of the business. He has unlimited liability to the third parties for the repayments of the firm's debts.
- (ii) Sarthak is a sleeping partner. A sleeping partner contributes capital to the firm but does not participate in the management of the firm. He shares profits and losses of the business. He has unlimited liability.

(iii) Dheeraj is a nominal partner. A nominal partner is one who allows the use of his name by a firm, but does not contribute capital. He does not take part in management of the firm. He generally does not share profit or losses. He has unlimited liability.

Question 4

Mr. Mukul Gupta contracted with a firm. According to the contract, he has advanced a loan of ` 20 lakh to the firm and in exchange he got the power to take a few decisions regarding the firm's business. Besides, he got 9% interest on the loan and 12% of profits earned by the firm.

Is Mr. Mukul Gupta a partner of the firm? Give reasons in support of your answer. **(4 marks)**



Answer 4

No, Mr. Mukul Gupta cannot be regarded as a partner of the firm because on the basis of the contract he has been given power to take a few decisions only, whereas to become a partner of the firm, the following additional conditions have to be fulfilled:

- (i) Unlimited liability: The partners of a firm have unlimited liability. Personal assets may be used for repaying debts.
- (ii) Risk bearing: The partners bear the risks involved in running the business. The reward comes in the form of profits which are shared by them in an agreed ratio.



Mutual agency: The partnership business can be carried on by all partners or any one of them acting for all. In other words, every partner is both an agent and a principal of other partners.

Company – Concept, Merits And Limitations

A company is an association of persons formed for carrying out business activities and has a legal status independent of its members. A company can be described as an artificial person having a separate legal entity, perpetual succession and a common seal.

The company form of organisation is governed by The Companies Act, 2013.

As per section 2(20) of the Companies Act, 2013, a company means company incorporated under this Act or any other previous company law.



Top Tip

Previous Company law means any of the laws specified below:

1. Act relating to companies in force before the Indian companies Act, 1866 (10 of 1866).
2. The Indian companies Act, 1866 (10 of 1866).
3. The Indian companies Act, 1882 (6 of 1882).
4. The Indian companies Act, 1913 (6 of 1913).
5. The Registration of Transferred Companies Ordinance, 1942 (ordinance 42 of 1942).
6. The Companies Act, 1956.

The shareholders are the owners of the company while the Board of Directors is the chief managing body elected by the shareholders.

Usually, the owners exercise an indirect control over the business.

The capital of the company is divided into smaller parts called 'shares' which can be transferred freely from one shareholder to another person (except in a private company).

Features

1. Separate legal entity

From the day of its incorporation, a company acquires an identity, distinct from its members. Its assets and liabilities are separate from those of its owners. The law does not recognise the business and owners to be one and the same.

2. Artificial person

A company is a creation of law and exists independent of its members. Like natural persons, a company can own property, incur debts, borrow money, enter into contracts, sue and be sued but unlike them it cannot breathe, eat, run, talk and so on. It is, therefore, called an artificial person.

3. Formation

The formation of a company is a time consuming, expensive and complicated process. It involves the preparation of several documents and compliance with several legal requirements before it can start functioning.

Incorporation of companies is compulsory under The Companies Act 2013 or any of the previous company law, as state earlier. Such companies which are incorporated under companies Act 1956 or any company law shall be included in the list of companies.

4. Perpetual succession

A company being a creation of the law, can be brought to an end only by law. It will only cease to exist when a specific procedure for its closure, called winding up, is completed. Members may come and members may go, but the company continues to exist. Thus, where all the members of a private company sitting in a general meeting were killed by a bomb but the company survived.

5. Control

The management and control of the affairs of the company is undertaken by the Board of Directors, which appoints the top management officials for running the business. The shareholders do not have the right to be involved in the day-to-day running of the business.

6. Liability

The liability of the members is limited to the extent of the capital contributed by them in a company. The creditors can use only the assets of the company to settle their claims since it is the company and not the members that owes the debt. The members can be asked to contribute to the loss only to the extent of the unpaid amount of share held by them.

Suppose Istuti is a shareholder in a company holding 2,000 shares of ₹10 each on which she has already paid ₹7 per share. Her liability in the event of losses or company's failure to pay debts can be only up to ₹6,000—the unpaid amount of her share capital (₹3 per share on 2,000 shares held in the company). Beyond

this, she is not liable to pay anything towards the debts or losses of the company.

7. Common seal

A company may or may not have a common seal. If a company has a common seal, it must be affixed to the documents such as agreements of a company. If a company does not have a common seal then the person signing the document should be authorised by a board's resolutions.

8. Risk bearing

The risk of losses in a company is borne by all the share holders. This is unlike the case of sole proprietorship or partnership firm where one or few persons respectively bear the losses. In the face of financial difficulties, all shareholders in a company have to contribute to the debts to the extent of their shares in the company's capital. The risk of loss thus gets spread over a large number of shareholders.

Merits and Limitations of Company Form of Organisation

Merits	Limitations
<ol style="list-style-type: none">1. Limited liability: The shareholders are liable to the extent of the amount unpaid on the shares held by them. Also, only the assets of the company can be used to settle the debts, leaving the owner's personal property free from any charge. This reduces the degree of risk borne by an investor.2. Transfer of interest: The ease of transfer of ownership adds to the advantage of investing in a company as the share of a public limited company can be sold in the market and as such can be easily converted into cash in case the need arises. This avoids blockage of investment and presents the company as a favourable avenue for investment purposes.3. Perpetual existence: Existence of a company is not affected by the death, retirement, resignation, insolvency or insanity of its members as it has a separate entity from its members. A company will continue to exist even if all the members die. It can be liquidated only as per the provisions of the Companies Act, 2013.	<ol style="list-style-type: none">1. Complexity in formation: The formation of a company requires greater time, effort and extensive knowledge of legal requirements and the procedures involved. As compared to sole proprietorship and partnership form of organisations, formation of a company is more complex.2. Lack of secrecy: The Companies Act requires each public company to provide from time-to-time a lot of information to the office of the registrar of companies. Such information is available to the general public also. It is, therefore, difficult to maintain complete secrecy about the operations of company.3. Impersonal work environment: Separation of ownership and management leads to situations in which there is lack of effort as well as personal involvement on the part of the officers of a company. The large size of a company further makes it difficult for the owners and top management to maintain personal contact with the employees, customers and creditors.4. Numerous regulations: The functioning of a company is subject to many legal provisions and compulsions. A company is burdened with numerous restrictions in respect of aspects including audit, voting, filing of reports and preparation of documents, and is required to obtain various certificates from different agencies, viz., registrar, SEBI, etc.5. Delay in decision making: Companies are democratically managed through the Board of Directors which is followed by the top management, middle management and lower level management. Communication as well as approval of various proposals may cause delays not only in taking decisions but also in acting upon them.

4. Scope for expansion: As compared to the sole proprietorship and partnership forms of organisation, a company has large financial resources. Further, capital can be attracted from the public as well as through loans from banks and financial institutions. Thus there is greater scope for expansion. The investors are inclined to invest in shares because of the limited liability, transferable ownership and possibility of high returns in a company.

5. Professional management: A company can afford to pay higher salaries to specialists and professionals. It can, therefore, employ people who are experts in their area of specialisations.

The scale of operations in a company leads to division of work. Each department deals with a particular activity and is headed by an expert. This leads to balanced decision making as well as greater efficiency in the company's operations.

6. Oligarchic management: A company is a democratic institution wherein the Board of Directors are representatives of the shareholders who are the owners. In practice, however, in most large sized organisations having a multitude of shareholders; the owners have minimal influence in terms of controlling or running the business. It is so because the shareholders are spread all over the country and a very small percentage attend the general meetings.

The Board of Directors as such enjoy considerable freedom in exercising their power which they sometimes use even contrary to the interests of the shareholders. Dissatisfied shareholders in such a situation have no option but to sell their shares and exit the company.

As the directors virtually enjoy the rights to take all major decisions, it leads to rule by a few.

7. Conflict in interest: There may be conflict of interest amongst various stakeholders of a company. The employees, for example, may be interested in higher salaries, consumers desire higher quality products at lower prices, and the shareholders want higher returns in the form of dividends and increase in the intrinsic value of their shares. These demands pose problems in managing the company as it often becomes difficult to satisfy such diverse interests.

Extra Shots

Indian Companies in League of FORTUNE GLOBAL Organisations

Company	GLOBAL Rank	Rank in India	Revenues (Million\$)	Website
Indian Oil Corporation Ltd.	161	1	54,711	www.iocl.com
Reliance Industries Ltd.	215	2	43,437	www.ril.com
Tata Motors Ltd.	226	3	42,092	www.tatamotors.com
State Bank of India	232	4	41,681	www.sbi.co.in
Bharat Petroleum Corporation Ltd.	350	5	20,082	www.bharatpetroleum.in
Hindustan Petroleum Corporation Ltd.	367	6	28,820	www.hindustanpetroleum.com
Rajesh Exports Corporation Ltd.	423	7	25,237	www.rajeshindia.com

Types of Companies

Private Company

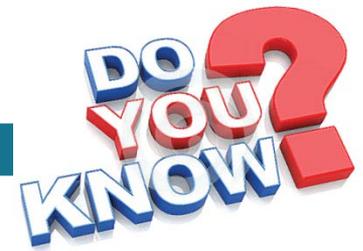
A private company means a company which:

- (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.



Note

1. It is necessary for a private company to use the word private limited after its name.
2. 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.



Minimum Subscription

The minimum amount that, in the opinion of directors, must be raised to meet the needs of business operations of the company. 'Minimum subscription' of capital cannot be less than 90% of the issued amount according to Securities and Exchange Board of India (SEBI) Guidelines.

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, 2013* 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.



Top Tip

A private company which is a subsidiary of a public company is also treated as a public company.

Difference between a Private Company and Public Company

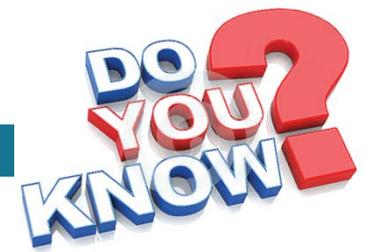
Basis	Public company	Private company
Members	Minimum - 7 Maximum - unlimited	Minimum - 2 Maximum - 200
Minimum number of directors	Three	Two
Index of members	Compulsory	Not compulsory
Transfer of shares	No restriction	Restriction on transfer
Invitation to public to subscribe to shares	Can invite the public to subscribe to its shares or debentures	Cannot invite the public to subscribe to its securities

The risk of loss thus gets spread over a large number of shareholders.

One Person Company

With the implementation of The Companies Act, 2013, a single person could constitute a company, under the One Person Company (OPC) concept. The introduction of OPC in the legal system is a move that would encourage corporatisation of micro businesses and entrepreneurship.

One Person Company (OPC) is a company with only one person as a member. That one person will be the shareholder of the company. It avails all the benefits of a private limited company such as separate legal entity, protecting personal assets from business liability and perpetual succession.



In India, in the year 2005, the JJ Irani Expert Committee recommended the formation of OPC. It had suggested that such an entity may be provided with a simpler legal regime through exemptions so that the small entrepreneur is not compelled to devote considerable time, energy and resources on complex legal compliance.

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.

Characteristics

1. Only a natural person who is an Indian citizen and resident in India:
 - (i) Shall be eligible to incorporate a One Person Company;
 - (ii) Shall be a nominee for the sole member of a One Person Company.



Note

For the purposes of this rule, the term “resident in India” means a person who has stayed in India for a period of not less than one hundred and eighty two days during the immediately preceding one calendar year.

2. No person shall be eligible to incorporate more than a One Person Company or become nominee in more than one such company.
3. Where a natural person, being member in One Person Company in accordance with this rule becomes a member in another such Company by virtue of his being a nominee in that One Person

Company, shall meet the eligibility criteria specified in sub rule (2) within a period of one hundred and eighty days.

4. No minor shall become member or nominee of the One Person Company or can hold share with beneficial interest.
5. Such Company cannot be incorporated or converted into a company under section 8 of the Act.
6. Such Company cannot carry out Non-Banking Financial Investment activities including investment in securities of anybody corporates.
7. No such company can convert voluntarily into any kind of company unless two years have expired from the date of incorporation of One Person Company,

except threshold limit such person (paid up share capital) is increased beyond ₹50 lakh or its average annual turnover during the relevant period exceeds ₹2 crore.

Formation of A Company – Stages and Important Documents

Formation of a company means bringing a company into existence and starting its business. It involves completion of a lot of legal formalities and procedures.

Formation of a company is a complex activity involving completion of legal formalities and procedures. To fully understand the process one can divide the formalities into three distinct stages, which are:

- I. Promotion;
- II. Incorporation and
- III. Subscription of capital.



Note

Private company as against the public limited company is prohibited to raise funds from public, it does not need to issue a prospectus and complete the formality of minimum subscription.

Company, except threshold limit such person (paid up share capital) is increased beyond ₹50 lakh or its average annual turnover during the relevant period exceeds ₹2 crore.

STAGE I: Promotion of a Company

Promotion is the first stage in the formation of a company. **It involves conceiving a business idea and taking an initiative to form a company so that practical shape can be given to exploiting the available business opportunity.**

Thus, it begins with somebody having discovered a potential business idea. Any person or a group of persons or even a company may have discovered an opportunity. If such a person or a group of persons or a company proceeds to form a company, then, they are said to be the promoters of the company.

A promoter is said to be the one who undertakes to form a company with reference to a given project and to set it going and who takes the necessary steps to accomplish that purpose. Thus, apart from conceiving a business opportunity the promoters analyse its prospects and bring together the men, materials, machinery, managerial abilities and financial resources and set the organisation going.

After thoroughly examining the feasibility of the idea, the promoters assemble resources, prepare necessary documents, give a name and perform various other activities to get a company registered and obtain the necessary certificate enabling the company to commence business. Thus, the promoters perform various functions to bring a company into existence.

Functions of a Promoter

1. Identification of business opportunity

The first and foremost activity of a promoter is to identify a business opportunity. The opportunity may be in respect of producing a new product or service or making some product available through a different channel or any other opportunity having an investment potential. Such opportunity is then analysed to see its technical and economic feasibility.

2. Feasibility studies

It may not be feasible or profitable to convert all identified business opportunities into real projects. The promoters, therefore, undertake detailed feasibility studies to investigate all aspects of the business they intend to start.

Depending upon the nature of the project, the following feasibility studies may be undertaken, with the help of the specialists like engineers, chartered accountants etc., to examine whether the perceived business opportunity can be profitably exploited.

- (a) **Technical feasibility:** Sometimes an idea may be good but technically not possible to execute. It may be so because the required raw material or technology is not easily available.
- (b) **Financial feasibility:** Every business activity requires funds. The promoters have to estimate the fund requirements for the identified business opportunity. If the required outlay for the project is so large that it cannot easily be arranged within the available means, the project has to be given up.

(c) Economic feasibility: Sometimes it so happens that a project is technically viable and financially feasible but the chance of it being profitable is very little. In such cases as well, the idea may have to be abandoned.



Top Tip

Promoters usually take the help of experts to conduct these studies. It may be noted that these experts do not become promoters just because they are assisting the promoters in these studies.

Only when these investigations throw up positive results, the promoters may decide to actually launch a company.

3. Name approval

Having decided incorporate to a company, the promoters have to select a name for it and submit an application to the registrar of companies of the state in which the registered office of the company is to be situated, for its approval.

The proposed name may be approved if it is not considered undesirable. It may happen that another company exists with the same name or a very similar name or the preferred name is misleading, say, to suggest that the company is in a particular business when it is not true. In such cases, the proposed name is not accepted but some alternate name may be approved. Therefore, three names, in order of their priority are given in the application to the Registrar of Companies.

4. Fixing up Signatories to the Memorandum of Association

Promoters have to decide about the members who will be signing the Memorandum of Association of the proposed company.

Usually the people signing memorandum are also the first Directors of the Company. Their written consent to act as Directors and to take up the qualification shares in the company is necessary.

5. Appointment of professionals

Certain professionals such as mercantile bankers, auditors etc., are appointed by the promoters to assist them in the preparation of necessary documents which are required to be with the Registrar of Companies.

The names and addresses of shareholders and the number of shares allotted to each is submitted to the Registrar in a statement called '*return of allotment*'.

6. Preparation of necessary documents

The promoter takes up steps to prepare certain legal documents, which have to be submitted under the law, to the Registrar of the Companies for getting the company registered. These documents are Memorandum of Association, Articles of Association and Consent of Directors.

Documents Required to be Submitted

1. Memorandum of Association

Memorandum of Association is the most important document as it defines the objectives of the company. No company can legally undertake activities that are not contained in its Memorandum of Association.

The Memorandum of Association contains different clauses, which are given as follows:

- (i) **The name clause:** This clause contains the name of the company with which the company will be known, which has already been approved by the Registrar of Companies.
- (ii) **Registered office clause:** This clause contains

the name of the state, in which the registered office of the company is proposed to be situated. The exact address of the registered office is not required at this stage but the same must be notified to the Registrar within thirty days of the incorporation of the company.

(iii) Objects clause: This is probably the most important clause of the memorandum. It defines the purpose for which the company is formed. A company is not legally entitled to undertake an activity, which is beyond the objects stated in this clause. The main objects for which the company is formed are listed in this sub-clause.



Top Tip

An act which is either essential or incidental for the attainment of the main objects of the company is deemed to be valid, although it may not have been stated explicitly.

(iv) Liability clause: This clause limits the liability of the members to the amount unpaid on the shares owned by them. For example, if a shareholder has purchased 1000 shares of ₹10 each and has already paid ₹ 6 per share, his/ her liability is limited to ₹ 4 per share. Thus, even in the worst case, he/she may be called upon to pay ₹ 4, 000 only.

(v) Capital clause: This clause specifies the maximum capital which the company will be authorised to raise through the issue of shares. The authorised share capital of the proposed company along with its division into the number of shares having a fixed face value is specified in this clause. For example, the authorised share capital of the company may be ₹25 lakhs with divided into 2.5 lakh shares of ₹10 each. The said company cannot issue share capital in excess of the amount mentioned in this clause.

The signatories to the Memorandum of Association state their intention to be associated with the company and give their undertaking to subscribe to the shares

mentioned against their names.

The Memorandum of Association must be signed by at least 7 persons in case of a public company and by 2 persons in case of a private company.

Extra Shots

The memorandum of a company shall be in respective forms specified in Tables A, B, C, D and E in Schedule I as may be applicable to such company.

Respective forms for Memorandum of Association

Table A	MOA of a company limited by shares
Table B	MOA of a company limited by guarantee and not having share capital
Table C	MOA of a company limited by guarantee and not having share capital
Table D	MOA of an unlimited company and not having share capital
Table E	MOA of an unlimited company and having share capital

A copy of a Memorandum of Association is given below:

“SCHEDULE I”

Table A

MEMORANDUM OF ASSOCIATION OF A COMPANY LIMITED BY SHARES

- 1st The name of the company is “..... Limited/Private Limited”.
- 2nd The registered office of the company will be situated in the State of
- 3rd (a) The objects to be pursued by the company on its incorporation are:-
.....
(b) Matters which are necessary for furtherance of the objects specified in clause 3 (a) are:-
.....
- 4th The liability of the member(s) is limited and this liability is limited to the amount unpaid, if any, on the shares held by them.
- 5th The share capital of the company is rupees, divided into shares of rupees each.
- 6th We, the several persons, whose names and addresses are subscribed, are desirous of being formed into a company in pursuance of this memorandum of association, and we respectively agree to take the number of shares in the capital of the company set against our respective names:

Names, addresses, descriptions and occupations of subscribers	No. of shares taken by each	Signature of subscriber	Signature, names addresses, descriptions and occupations of witnesses
A.B. of Merchant		Signed before me: Signature
C.D. of Merchant		Signed before me: Signature
E.F. of Merchant		Signed before me: Signature
G.H. of Merchant		Signed before me: Signature
I.J. of Merchant		Signed before me: Signature
K.L. of Merchant		Signed before me: Signature
M.N. of Merchant		Signed before me: Signature
Total shares taken:			

7th I, whose name and address is given below, am desirous of forming a company in pursuance of this memorandum of association and agree to take all the shares in the capital of the company (Applicable in case of one person company):

Names, addresses, occupations of Subscribers	Signature of subscribed	Signature, name, address, description and occupation of witness
--	-------------------------	---

8th Shri/Smt, son/daughter of, resident of
aged years shall be the nominee in the event of death of the sole member (Applicable in case of one person company)
Dated The day of

2. Articles of Association

Articles of Association are the rules regarding internal management of a company. These rules are subsidiary to the Memorandum of Association and hence, should not contradict or exceed anything stated in the Memorandum of Association.

Extra Shots

The Articles generally contains the following matters:

- Number and value of shares
- Calls on shares
- Transfer and transmission of shares
- Forfeiture of shares
- Conversion of shares into stock
- Voting rights and proxies
- Meetings and rules regarding committees
- Directors, their appointment and delegations of powers
- Issue of Debentures and stocks
- Managing director, Whole-time director, Manager, Secretary
- Additional directors
- Directors meetings
- Dividends and reserves
- Winding up
- Allotment of shares
- Buy back of shares
- Alteration of capital
- Dematerialization
- General meetings
- Audit committee
- Remuneration of directors
- Borrowing powers
- Accounts and audit
- Indemnity

The articles of a company shall be in respective forms as specified in Table F, G, H, I and J in schedule I as may be applicable to such company.

Respective forms for Articles of a Company

Table F	AOA of a company limited by shares
Table G	AOA of a company limited by guarantee and having share capital
Table H	AOA of a company limited by guarantee and not having share capital
Table I	AOA of an unlimited company and having share capital
Table J	AOA of an unlimited company and not having share capital

However, the companies are free to make their own articles of association which may be contrary to the clauses of Table F, G, H, I, J and in that case articles of association as adopted by the company shall apply.

Difference between Memorandum of Association and Articles of Association

Basis of Difference	Memorandum of Association	Articles of Association
Objectives	Memorandum of Association defines the objects for which the company is formed.	Articles of Association are rules of internal management of the company. They indicate how the objectives of the company are to be achieved.
Position	This is the main document of the company and is subordinate to the Companies Act.	This is a subsidiary document and is subordinate to both the Memorandum of Association and the Companies Act.
Relationship	Memorandum of Association defines the relationship of the company with outsiders.	Articles define the relationship of the members and the company.

Validity	Acts beyond the Memorandum of Association are invalid and cannot be ratified even by a unanimous vote of the members.	Acts which are beyond Articles can be ratified by the members, provided they do not violate the Memorandum.
Necessity	Every company has to file a Memorandum of Association.	It is not compulsory for a public ltd. company to file Articles of Association. It may adopt Table F of The Companies Act, 2013

3. Consent of Proposed Directors

A part from the Memorandum and Articles of Association, a written consent of each person named as a director is required confirming that they agree to act in that capacity and undertake to buy and pay for qualification shares, as mentioned in the Articles of Association.



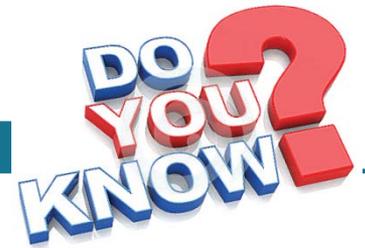
Note

Qualification Shares

To ensure that the directors have some stake in the proposed company, the Articles usually have a provision requiring them to buy a certain number of shares. They have to pay for these shares before the company obtains Certificate of Commencement of Business. These are called Qualification Shares.

4. Agreement

The agreement, if any, which the company proposes to enter with any individual for appointment as its Managing Director or a whole time Director or Manager is another document which is required to be submitted to the Registrar for getting the company registered under the Act.



Director Identification Number (DIN)

Every Individual intending to be appointed as director of a company shall make an application for allotment of Director Identification Number (DIN) to the Central Government in prescribed form along with fees. The Central Government shall allot a Director Identification Number to an application within one month from the receipt of the application. No individual, who has already been allotted a Director Identification Number, shall apply for, obtain or possess another Director Identification Number (DIN).

5. Statutory Declaration

A declaration stating that all the legal requirements pertaining to registration have been complied with is to be submitted to the Registrar with the above mentioned documents for getting the company registered under the law. This statement can be signed by

an advocate or by a Chartered Accountant or a Cost Accountant or a Company Secretary in practice who is engaged in the formation of a company and by a person named in the articles as a director or manager or secretary of the company.

6. Receipt of Payment of fee

Along with the above-mentioned documents, necessary fees has to be paid for the registration of the company. The amount of such fees shall depend on the authorised share capital of the company.

Position of Promoters

1. Promoters are neither the agents nor the trustees of the company.

➤ Promoters can't be the agents as the company is yet to be incorporated. Therefore, they are personally liable for all the contracts which are entered by them, for the company before its incorporation, in case the same are not ratified by the company later on.

➤ Also promoters are not the trustees of the company.

2. Promoters of a company enjoy a fiduciary position with the company, which they must not misuse.

They can make a profit only if it is disclosed but must not make any secret profits. In the event of a non-disclosure, the company can rescind the contract and recover the purchase price paid to the promoters. It can also claim damages for the loss suffered due to the non-disclosure of material information.

3. Promoters are not legally entitled to claim the expenses incurred in the promotion of the company.

However, the company may choose to reimburse them for the pre-incorporation expenses. The company may also remunerate the promoters for their efforts by paying a lump sum amount or a commission on the purchase price of property purchased through them or on the shares sold. The company may also allot them shares or debentures or give them an option to purchase the securities at a future date.

STAGE II: Incorporation

After completing the aforesaid formalities, promoters make an application for the incorporation of the company. The application is to be filed with the Registrar of Companies of the state within which they plan to establish the registered office of the company. The application for registration must be accompanied with the following documents:

1. The Memorandum of Association duly stamped, signed and witnessed. In case of a public company, at least seven members must sign it. For a private company however the signatures of two members are sufficient. The signatories must also give information about their address, occupation and the number of shares subscribed by them.

2. The Articles of Association duly stamped and witnessed as in case of the Memorandum. However, a public company may adopt Table A, which is a model set of Articles, given in the Companies Act. In that case, a statement in lieu of the prospectus is submitted, instead of Articles of Association.
3. Written consent of the proposed directors to act as directors and an undertaking to purchase qualification shares.
4. The agreement, if any, with the proposed Managing Director, Manager or whole-time director.
5. A copy of the Registrar's letter approving the name of the company.
6. A statutory declaration affirming that all legal

requirements for registration have been complied with. This must be duly signed.

7. A notice about the exact address of the registered office may also be submitted along with these documents. However, if the same is not submitted at the time of incorporation, it can be submitted within 30 days of the receipt of the certificate of incorporation.
8. Documentary evidence of payment of registration fees.

The Registrar upon submission of the application along with the required documents has to be satisfied that the documents are in order and that all the statutory requirements regarding the registration have been complied with.

However, it is not his duty to carry out a thorough investigation about the authenticity of the facts mentioned in the documents. When the Registrar is satisfied, about the completion of formalities for registration, a **Certificate of Incorporation** is issued to the company, which signifies the birth of the company. *The certificate of incorporation may therefore be called the birth certificate of the company.*



Note

With effect from November 1, 2000, the Registrar of Companies allots a CIN (Corporate Identity Number) to the Company.

Effect of the Certificate of Incorporation

A company is legally born on the date printed on the Certificate of Incorporation. It becomes a legal entity with perpetual succession on such date. It becomes entitled to enter into valid contracts.

The Certificate of Incorporation is a conclusive evidence of the regularity of the incorporation of a company. The legal situation is that once a Certificate of Incorporation has been issued, the company has become a legal business entity irrespective of any flaw in its registration. The Certificate of Incorporation is thus conclusive evidence of the legal existence of the company.

Some interesting examples showing the impact of the conclusiveness of the Certificate of Incorporation are as under:

1. Documents for registration were filed on 6th January. Certificate of Incorporation was issued on 8th January. But the date mentioned on the Certificate was 6th January. It was decided that the company was in existence and the contracts signed on 6th January were considered valid.
2. A person forged the signatures of others on the Memorandum. The Incorporation was still considered valid.

Thus, whatever be the deficiency in the formalities, the Certificate of Incorporation once issued, is a conclusive evidence of the existence of the company. Even when a

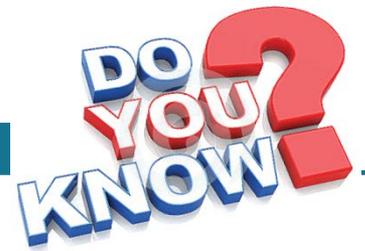
company gets registered with illegal objects, the birth of the company cannot be questioned. The only remedy available is to wind it up.

Because the Certificate of Incorporation is so crucial, the Registrar has to go very carefully before issuing it.



Note

On the issue of Certificate of Incorporation, a private company can immediately commence its business. It can raise necessary funds from friends, relatives or through private arrangement and proceed to start business.



Preliminary Contracts (or pre-incorporation contracts): Contracts signed by promoters with third parties before the incorporation of company.

During the promotion of the company, promoters enter into certain contracts with third parties on behalf of the company. These are called preliminary contracts or pre-incorporation contracts. These are not legally binding on the company. A company after coming into existence may, if it so chooses, decide to enter into fresh contracts with the same terms and conditions to honour the contracts made by the promoters. Note that it cannot ratify a preliminary contract. A company thus cannot be forced to honour a preliminary contract. Promoters, however, remain personally liable to third parties for these contracts.

Provisional Contracts: Contracts signed after incorporation but before commencement of business.

STAGE III: Capital Subscription

A public company can raise the required funds from the public by means of issue of securities (shares and debentures etc.). For doing the same, it has to issue a prospectus which is an invitation to the public to subscribe to the capital of the company and undergo various other formalities.

Steps for raising funds from the public

1. SEBI Approval

SEBI (Securities and Exchange Board of India) which is the regulatory authority in our country. A public company inviting funds from the general public must make adequate disclosure of all relevant information and must

not conceal any material information from the potential investors. This is necessary for protecting the interest of the investors. Prior approval from SEBI is, therefore, required before going ahead with raising funds from public.

2. Filing of Prospectus

A copy of the prospectus or statement in lieu of prospectus is filed with the Registrar of Companies.

A prospectus is an invitation to the public to apply for securities (shares, debentures etc.) of the company or to make deposits in the company.



Note

Investors make up their minds about investment in a company primarily on the basis of the information contained in this document. Therefore, there must not be a mis-statement in the prospectus and all material significant information must be fully disclosed.

3. Appointment of Bankers, Brokers, Underwriters

Raising funds from the public is a stupendous task.

- The application money is to be received by the bankers of the company.
- The brokers try to sell the shares by distributing the forms and encouraging the public to apply for the shares.
- If the company is not reasonably assured of a good public response to the issue, it may appoint underwriters to the issue. Underwriters undertake to buy the shares if these are not subscribed by the public. They receive a commission for underwriting the issue. Appointment of underwriters is not necessary.

4. Minimum Subscription

In order to prevent companies from commencing business with inadequate resources, it has been provided that the company must receive applications for a certain minimum number of shares before going ahead with the allotment

of shares. According to the Companies Act, this is called the 'minimum subscription'.

As per the SEBI Guidelines, the limit of 'minimum subscription' is 90% of the size of the issue.

Thus, if applications received for the shares are for an amount less than 90% of the issue size, the allotment cannot be made and the application money received must be returned to the applicants.

5. Application to Stock Exchange

An application is made to at least one stock exchange for permission to deal in its shares or debentures.

If such permission is not granted before the expiry of 10 weeks from the date of closure of subscription list, the allotment shall become void and all money received from the applicants will have to be returned to them within 8 days.

6. Allotment of Shares

Till the time shares are allotted, application money received should remain in a separate bank account and must not be used by the company. In case the number of shares allotted is less than the number applied for, or where no shares are allotted to the applicant, the excess application money, if any, is to be returned to applicants or adjusted towards allotment money due from them. Allotment letters are issued to the successful allottees.

‘Return of allotment’, signed by a director or secretary is filed with the Registrar of Companies within 30 days of allotment.

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



Sole Proprietorship

Sole proprietorship refers to a form of business organisation which is owned, managed and controlled by an individual, who is the recipient of all profits and bearer of all risks.

Features

1. Ease of formation and closure
2. Unlimited liability
3. No separate entity
4. Sole risk bearer and profit recipient
5. Full control
6. Lack of business continuity

Merits

1. Quick decision making

2. Confidentiality of information
3. Ease of formation and closure
4. Direct incentive
5. Sense of accomplishment

Limitations

1. Limited resources
2. Limited life of a business concern
3. Unlimited liability
4. Limited managerial ability

Hindu Undivided Family Business

It is one of the oldest forms of business organisation found only in India. Business is owned and carried on by the members of the Hindu Undivided Family (HUF). The business is controlled by the head of the family, who is the eldest member and is called 'Karta'. He takes all the decisions to manage the business. All members have equal ownership right over the

property and they are known as 'Co-parceners'.

Features

1. Ease of formation
2. Liability (Karta—unlimited, Co parceners—limited)
3. Control of Karta
4. Continuity
5. Minor Members

Cooperative Society

A 'cooperative society' is a voluntary association of persons for mutual benefit. Its primary motive is welfare of the members.

Features

1. Voluntary membership
2. Legal status

3. Limited liability
4. Democratic control
5. Service motive

Merits

1. Ease of formation
2. Equality in voting status
3. Limited liability
4. Stable existence
5. Economy in operations
6. Support from government

Limitations

1. Limited resources
2. Inefficiency in management
3. Lack of secrecy

4. Differences of opinion

5. Government control

Types of Cooperative Societies

1. Consumers' cooperative societies

2. Producers' cooperative societies

3. Marketing cooperative societies

4. Farmers' cooperative societies

5. Credit cooperative societies

6. Cooperative housing societies

Partnership

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all.

Features

1. Formation: It comes into existence with an agreement (written or oral) among the partners.
2. Membership: Minimum—2
3. Unlimited liability
4. Risk bearing Maximum—50
5. Joint decision making and control
6. Mutual agency
7. Continuity

Merits

1. Ease of formation and closure
2. Balanced decision making
3. More funds
4. Sharing of risks
5. Secrecy

Limitations

1. Unlimited liability
2. Limited resources
3. Possibility of conflicts
4. Lack of continuity
5. Lack of public confidence

Types of Partners

1. Active Partner
2. Sleeping or Dormant Partner
3. Secret Partner
4. Nominal Partner
5. Partner by Estoppel

Types of Partnership

1. Partnership at will

2. Particular partnership
3. General Partnership
4. Limited Partnership

Registration of Partnership Firm

Registration of a partnership firm is not compulsory. It is optional. However, a partner of an unregistered firm cannot file a suit against the firm or any third party. Firm cannot file a suit against any partner or a third party.

Company

A company is an association of many persons who contribute money and employ it in some trade or business, and who share the profit and loss arising thereof. The persons who contribute money are its members.

Features

1. Formation – complex

2. Separate legal entity
3. Artificial person
4. Limited Liability
5. Perpetual succession
6. Control of the Board of Directors
7. Common seal
8. Risk bearing

Merits

1. Limited liability
2. Transfer of interest
3. Perpetual existence
4. Scope for expansion
5. Professional management

Limitations

1. Complexity in formation
2. Lack of secrecy
3. Impersonal work environment
4. Numerous regulations
5. Delay in decision making
6. Oligarchic management
7. Conflict in interest

Types of Companies

A private company is one which restricts transfer of shares and does not invite the public to subscribe to its securities.

A public company, on the other hand, is allowed to raise its funds by inviting the public to subscribe to its securities. Furthermore, there is a free transferability of securities in the case of a public company.

One Person Company (OPC) is a company with only one person as a member. That one person will be the shareholder of the company. It avails all the benefits of a private limited company such as separate legal entity, protecting personal assets from business liability and perpetual succession.

Formation of a company

There are two stages in the formation of a private company, promotion and incorporation. A public company has to undergo capital subscription stage to begin operations.

1.Promotion: It begins with a potential business idea. Certain feasibility studies e.g., technical, financial and economic, are conducted to determine whether the idea can be profitably exploited. In case, the investigations yield favourable results, promoters may decide to form the company. Persons who conceive the business idea, decide to form a company, take necessary steps for the same, and assume associated risks, are called promoters.

Steps in Promotion

- (i) Approval of company's name is taken from the Registrar of Companies
- (i) Signatories to the Memorandum of Association are fixed
- (iii) Certain professionals are appropriated to assist the promoters
- (iv) Documents necessary for registration are prepared

Necessary Documents

- Memorandum of Association
- Articles of Association
- Consent of proposed directors
- Agreement, if any, with proposed managing or whole time director
- Statutory declaration

2. **Incorporation:** An application is made by promoters to the Registrar of Companies along with necessary documents and registration fee. The Registrar, after due scrutiny, issues certificate of incorporation. The certificate of incorporation is a conclusive evidence of the legal existence of the company.
3. **Capital Subscription:** A public company raising funds from the public needs to take following steps for fund raising:
 - (i) SEBI approval;
 - (ii) File a copy of prospectus with the Registrar of Companies;
 - (iii) Appointment of brokers, bankers and underwriters etc.;
 - (iv) Ensure that minimum subscription is received;
 - (v) Application for listing of company's securities;

- (vi) Refund/adjust excess application money received;
- (vii) Issue allotment letters to successful applicants; and
- (viii) File return of allotment with the Registrar of Companies (ROC).



Key Terms

Sole proprietorship refers to a form of business organisation which is owned, managed and controlled by an individual who is the recipient of all profits and bearer of all risks.

Unlimited liability – This implies that the owner is personally responsible for payment of debts in case the assets of the business are not sufficient to meet all the debts.

Joint Hindu family business refers to a form of organisation wherein the business is owned and carried on by the members of the Hindu Undivided Family (HUF).

Karta – Joint Hindu family business is controlled by the head of the family who is the eldest member and is called karta.

Co-parceners – In a Joint Hindu family business, all members have equal ownership right over the property of an ancestor and they are known as co-parceners.

Cooperative society is a voluntary association of persons, who join together with the motive of welfare of the members.

Consumer's cooperative societies – The consumer cooperative societies are formed to protect the interests of consumers.

Producer's cooperative societies – These societies are set up to protect the interest of small producers.

Marketing cooperative societies – Such societies are established to help small producers in selling their products.

Farmer's cooperative societies – These societies are established to protect the interests of farmers by providing better inputs at a reasonable cost.

Credit cooperative societies – Credit cooperative societies are established for providing easy credit on reasonable terms to the members.

Cooperative housing societies – Cooperative housing societies are established to help people with limited income to construct houses at reasonable costs.

Partnership is the relation between persons who have agreed to share the profits of a business carried on by all or any of them acting for all.

Mutual agency – The business of a partnership concern may be carried on by all the partners or any of them acting for all. Every partner is entitled to participate in the conduct of the affairs of its business. Each partner carrying on the business is the principal as well as the agent for all the other partners.

Partnership at will – Partnership formed at the will of the partners is called 'partnership at will'. It can continue as long as the partners want and is terminated when any partner gives a notice of withdrawal from partnership to the firm.

Particular partnership – Partnership formed for the accomplishment of a particular project say construction of a building or an activity to be carried on for a specified time period is called 'particular partnership'.

General Partnership – In general partnership, the liability of partners is unlimited and joint.

Limited Partnership – In limited partnership, the liability of at least one partner is unlimited whereas the rest may have limited liability.

Active Partner – An active partner is one who takes actual part in carrying out business of the firm on behalf of other partners.

Sleeping or Dormant Partner – Partners who do not take part in the day to day activities of the business are called sleeping partners.

Secret Partner – A secret partner is one whose association with the firm is unknown to the general public. Contributes to the capital of the firm.

Nominal Partner – A nominal partner is one who allows the use of his/her name by a firm.

Partner by Estoppel – A person is considered a partner by estoppel if, through his/her own initiative, conduct or behaviour, he/she gives an impression to others that he/she is a partner of the firm.

Minor as a Partner – A minor is incompetent to enter into a valid contract with others, he cannot become a partner in any firm. However, a minor can be admitted to the benefits of a partnership firm with the mutual consent of all other partners.

Registration of a partnership firm means the entering of the firm's name, along with the relevant prescribed particulars, in the Register of firms kept with the Registrar of Firms. It provides conclusive proof of the existence of a partnership firm.

Partnership deed – The written agreement which specifies the terms and conditions that govern the partnership is called the partnership deed.

Company is an association of persons formed for carrying out business activities and has a legal status independent of its members. A company can be described as an artificial person having a separate legal entity, perpetual succession and a common seal.

Perpetual succession – A company being a creation of the law, can be brought to an end only by law. It will only cease to exist when a specific procedure for its closure, called winding up, is completed. Members may come and members may go, but the company continues to exist.

Private company means a company which restricts the right of members to transfer its shares; has a minimum of 2 and a maximum of

200 members, excluding the present and past employees; and does not invite public to subscribe to its securities.

Minimum Subscription – The minimum amount that, in the opinion of directors, must be raised to meet the needs of business operations of the company. ‘Minimum subscription’ of capital cannot be less than 90% of the issued amount according to Securities and Exchange Board of India (SEBI) Guidelines.

Public company is one which has a minimum of 7 members and no limit on maximum members; has no restriction on transfer securities; and is not prohibited from inviting the public to subscribe to its securities.

One Person Company (OPC) is a company with only one person as a member. That one person will be the shareholder of the company. It avails all the benefits of a private limited company such as separate legal entity, protecting personal assets from business liability and perpetual succession.

Promotion is the first stage in the formation of a company. It involves conceiving a business idea and taking an initiative to form

a company so that practical shape can be given to exploiting the available business opportunity.

Promoter is said to be the one who undertakes to form a company with reference to a given project and to set it going and who takes the necessary steps to accomplish that purpose.

Technical feasibility – Sometimes an idea may be good but technically not possible to execute. It may be so because the required raw material or technology is not easily available.

Financial feasibility – Every business activity requires funds. The promoters have to estimate the fund requirements for the identified business opportunity. If the required outlay for the project is so large that it cannot easily be arranged within the available means, the project has to be given up.

Economic feasibility – Sometimes it so happens that a project is technically viable and financially feasible but the chance of it being profitable is very little. In such cases, the idea may have to be abandoned.

Memorandum of Association is the most important document as it defines the objectives of the company. No company can legally undertake activities that are not contained in its Memorandum of Association.

Name clause contains the name of the company with which the company will be known, which has already been approved by the Registrar of Companies.

Registered office clause contains the name of the state, in which the registered office of the company is proposed to be situated.

Objects clause defines the purpose for which the company is formed.

Liability clause limits the liability of the members to the amount unpaid on the shares owned by them.

Capital clause specifies the maximum capital which the company will be authorised to raise through the issue of shares.

Articles of Association are the rules regarding internal management of a company. These rules are subsidiary to the Memorandum of Association and hence, should not contradict or exceed anything stated in the Memorandum of Association.

Qualification Shares – To ensure that the directors have some stake in the proposed company, the Articles usually have a provision requiring them to buy a certain number of shares. They have to pay for these shares before the company obtains Certificate of Commencement of Business. These are called Qualification Shares.

Certificate of Incorporation is issued to the company, which signifies the birth of the company. The Certificate of Incorporation is a conclusive evidence of the regularity of the incorporation of a company. The legal situation is that once a Certificate of Incorporation has been issued, the company has become a legal business entity irrespective of any flaw in its registration.

Preliminary Contracts (or pre-incorporation contracts) – Contracts signed by promoters with third parties before the incorporation of company.

Provisional Contracts – Contracts signed after incorporation but before commencement of business.

Prospectus is an invitation to the public to apply for securities (shares, debentures etc.) of the company or to make deposits in the company.

Statement in Lieu of Prospectus – A public company may not invite public to subscribe to its securities (shares, debentures etc.). Instead, it can raise the funds through friends, relatives or some private arrangements as done by a private company. In such cases, there is no need to issue a prospectus. A ‘Statement in Lieu of Prospectus’ is filed with the Registrar of Companies (ROC) at least 3 days before making the allotment.

Objective Type Questions 2.3

Question 1

Match the columns:

(a) The document containing the rules, regulations and bye-laws of a company.	(i) Articles of Association
(b) The document inviting subscriptions for shares and debentures.	(ii) Memorandum of Association
(c) The amount of money which must be raised before allotment of shares.	(iii) Prospectus
(d) The principal document of a company.	(iv) Minimum subscription



Answer 1

(a) – (i), (b) – (iii), (c) – (iv), (d) – (ii)



Question 2

The structure in which there is separation of ownership and management is called

(Choose the correct alternative)

- (a) Sole proprietorship
- (b) Partnership
- (c) Company
- (d) All business organisations



Answer 2

(c) Company



Question 3

The board of directors of a Joint stock company is elected by *(Choose the correct alternative)*

- (a) General public
- (b) Government bodies
- (c) Shareholders
- (d) Employees



Answer 3

(c) Shareholders



Question 4

The capital of a company is divided into number of parts, each one of which is called

(Choose the correct alternative)

- (a) Dividend
- (b) Profit
- (c) Interest
- (d) Share



Answer 4

(d) Share



Question 5

Maximum number of members in a private company can be *(Choose the correct alternative)*

- (a) 20
- (b) 10
- (c) 50
- (d) 200



Answer 5

(d) 200



Question 6

Minimum number of members to form a public company is
(Choose the correct alternative)

- (a) 5
- (b) 12
- (c) 7
- (d) 21



Answer 6

(c) 7



Question 7

Application for approval of name of a company is to be made to *(Choose the correct alternative)*

- (a) SEBI
- (b) Registrar of Companies
- (c) Government of India
- (d) Government of the State in which Company is to be registered



Answer 7

(b) Registrar of Companies



Question 8

A proposed name of Company is considered undesirable If
(Choose the correct alternative)

- (a) It is identical with the name of some other company
- (b) It resembles closely with the name of an existing company
- (c) It is an emblem of Government of India, United Nations, etc.
- (d) In case of any of the above

Answer 8

(d) In case of any of the above



Question 9

A prospectus is issued by

(Choose the correct alternative)

- (a) A private company
- (b) A public company seeking investment from public
- (c) A public enterprise
- (d) A public company



Answer 9

(b) A public company seeking investment from public



Question 10

Stages in the formation of a public company are in the following order *(Choose the correct alternative)*

- (a) Promotion, Commencement of Business, Incorporation, Capital Subscription
- (b) Incorporation, Capital Subscription, Commencement of Business, Promotion
- (c) Promotion, Incorporation, Capital Subscription, Commencement of Business
- (d) Capital Subscription, Promotion, Incorporation, Commencement of Business

Answer 10

(c) Promotion, Incorporation, Capital Subscription,
Commencement of Business



Question 11

A company cannot come into existence without:

(Choose the correct alternative)

- (a) electing directors
- (b) getting Certificate of Incorporation
- (c) issuing a prospectus
- (d) all of these



Answer 11

(b) getting Certificate of Incorporation



Question 12

Every company must have Articles of Association.

True /False. Give reason?



Answer 12

False : A public limited company may adopt the rules of Table F.



Question 13

Acts against the Memorandum are ultra vires.

True /False. Give reason?



Answer 13

True: If a company does anything that is not provided for in the Memorandum of Association, it will be treated as ultra-vires, i.e., beyond the legal power and authority of the company.



Question 14

A company can enter into contracts, file suits against others, and hire persons. *True/False? Give reason.*



Answer 14

True: A company is created by law. It has a separate legal status.



Question 15

If a majority of its shareholders are dead, the company has to be wound up too. *True/False? Give reason.*



Answer 15

False: Being a separate legal entity, the death of even all its members does not affect its life. It is stable. **False:** Being a separate legal entity, the death of even all its members does not affect its life. It is stable.



Question 16

If the assets of a company are not enough to pay off its liabilities, personal assets of its shareholders may be taken over for the purpose. *True/False? Give reason.*



Answer 16

False: The liability of the members is limited to the face value of the shares held by them.



Question 17

It is necessary to get every company incorporated, whether private or public. *True/False? Give reason.*



Answer 17

True: Incorporation/registration of every company is must with the Registrar of Companies. Every company (public or private) must get 'Certificate of Incorporation' to have legal status.



Question 18

Name the type of company in which there is restriction on the maximum number of members. What is that number?



Answer 18

Private company; maximum number of members can be 200, excluding present and past employees.



Question 19

Name the type of company which cannot invite public to subscribe to its share capital.



Answer 19

Private company.



Question 20

Why is a company called an artificial person?



Answer 20

A company is called an artificial person because it does not possess the body of a natural being. It cannot breathe, eat, run, talk and so on.



Question 21

What is the minimum number of directors for a private company and a public company?



Answer 21

- (i) Private company— 2
- (ii) Public company— 3



Question 22

When can a private company commence its business?



Answer 22

A private company can commence its business after incorporation.



Question 23

When can a public company commence business?



Answer 23

A public company can commence business only after receiving 'Certificate of Commencement of Business'.



Question 24

Mention any two documents which are filed with the Registrar of Companies for incorporation of a company.



Answer 24

- (i) Memorandum of Association
- (ii) Articles of Association



Question 25

At which stage in the formation of a company does it interact with SEBI?



Answer 25

Capital subscription stage



Question 26

Name the document by which a company becomes a distinct legal entity.



Answer 26

Certificate of Incorporation



Question 27

Which document is called charter of the company?



Answer 27

Memorandum of Association



Question 28

Name the document which invites the general public to subscribe to the shares and debentures of the company.



Answer 28

Prospectus



Question 29

Name the document containing the rules and bye-laws of the company.



Answer 29

Articles of Association



Question 30

A person forged the signatures of others on the Memorandum of Association. But the Registrar issued the 'Certificate of Incorporation'. Was the registration of the company valid?



Answer 30

Yes, the registration of the company was valid since the 'Certificate of Incorporation' is the conclusive evidence of the legal existence of the company.



Question 31

Name the form of business enterprise where there is separation of ownership and management.



Answer 31

Company form of business.



Question 32

Who manages and controls the affairs of the company?



Answer 32

Board of Directors



Question 33

Why does a company enjoy perpetual succession?



Answer 33

Because it is created by law. It has a separate legal status. The death, insolvency or retirement of its members does not affect the life of the company.



Question 34

What is a Certificate of Incorporation?



Answer 34

Certificate of Incorporation is like the birth certificate of the company. It is conclusive evidence of legal status of a company.



Question 35

Name the document which authorises a public company to start its business.



Answer 35

Certificate of Commencement of Business.



Question 36

What is a Certificate of Incorporation?



Answer 36

Certificate of Incorporation is like the birth certificate of the company. It is conclusive evidence of legal status of a company.



Question 37

Name the document which authorises a public company to start its business.



Answer 37

Certificate of Commencement of Business.



Question 38

Name the process by which the shares of a company are allowed to be traded on a stock exchange.



Answer 38

Listing of shares



Case Studies 2.3

Question 1

Mr. Arjun is a sole proprietor. He has been doing the wholesale business of tea for the last three years. The brand name of his tea is 'Tadka Chay'. This is a popular brand of its region. Now Mr. Arjun has been worried about two issues. First, his business unit is situated in an unorganised sector and therefore, he is unable to buy goods on credit from any trader easily. Similarly, banks and other lending institutions hesitate to extend a long-term loan to him. Such a treatment by the people produces the

inferiority complex in him. The second issue worrying him is that he has unlimited liability. If unfortunately he suffers a heavy loss in business, his business property and personal property both will be finished. He wants to get rid of these worries. So he contacts a business specialist, who suggests a new form of business organisation which will remove all his problems.

In your opinion what advice must have been given to Mr. Arjun by the business specialist? Explain.

(3 marks)



Answer 1

The business specialist must have advised Mr. Arjun to establish One Person Company (OPC).

The Indian Companies Act, 2013 introduces a new type of entity to the existing list, i.e., apart from forming a public or private limited company, the 2013 Act enables the formation of a new entity a 'one-person company' (OPC). An OPC means a company with only one person as its member.

Rule 3(1) provides that only a natural person who is an Indian citizen and resident in India shall be eligible to incorporate OPC. No person shall be eligible to

incorporate more than one OPC or become nominee in more than one such company.

Question 2

XYZ Ltd. took a loan of ₹ 50 lakh from a bank for its growth and expansion plans. The company was unable to repay the loan amount because of heavy losses incurred in the business on a continuous basis. The management of the company asked its shareholders to contribute towards repayment of the loan. But the shareholders refused as they had already paid the full amount due on their shares. The bank filed a case against XYZ Ltd. in the court. The court held that the shareholders of the company were not liable to repay the loan as they had not unpaid amount on shares.

-
- (a) Is the court's decision justified? Give reason in support of your answer.
- (b) Which characteristic of the company form of organisation protected the shareholders? Explain.

(4 marks)

Answer 2

- (a) Yes, the court's decision is justified because the shareholders of a company have limited liability.

The liability of the members is limited to the face value of the shares held by them. They are not personally liable to the debts of the company.

- (b) Separate Legal Entity

A company is a legal entity distinct from its shareholders, directors and promoters. It can carry on business in its own name, enter into contracts, buy, sell and hold property, sue and be sued.

Question 3

A group of seven friends decided to jointly set up a public company in a rural area where the people were facing a serious unemployment problem. All of them jointly selected a place where the company's registered office would be situated. Along with it, with the advice of business specialists, it was also decided what procedure would be followed for the issue and allotment of shares. All the friends wanted their company to have a singular recognition, and people should get immediate attraction towards its products. It was felt that the very name of the company could become a reason for its recognition.

After a detailed discussion, the company's name was decided as Trimurti Ltd. Then, they jointly completed all the formalities of the formation of the company.

Identify and explain the two important documents used in the formation of the company quoting the lines from the above para which helped you identify these documents. **(5 marks)**



Answer 3

(a) Consumers' Cooperative Society

Its purpose is to protect the interests of consumers. Consumers desirous of obtaining good quality products at reasonable prices become its members. It purchases goods in bulk directly from the wholesalers and sells goods to the members.

(b) The Cooperative Societies Act, 1912

(c) Limited Liability

The liability of the members of a cooperative society is limited to the extent of the amount contributed by them as capital.



(i) Memorandum of Association

“All of them jointly selected a place where the company’s registered office would be situated.”
(Situation Clause)

“After a detailed discussion, the company’s name was decided as Trimurti Ltd.” (Name Clause)

Memorandum of Association is the principal document of a company. No company can be registered without a Memorandum of Association; and that is why it is sometimes called a ‘life-giving document’. Memorandum of Association defines the

powers and objects of the company as well as the scope of operations of the beyond which it cannot operate.

(ii) Articles of Association

“...it was also decided what procedure would be followed for the issue and allotment of shares.”

The Articles of Association are the rules for the internal management of the affairs of a company.

The articles define the duties, rights and powers of the officers and the board of directors. The

rules contained in the Articles of Association are subsidiary to the Memorandum of Association.

Question 4

Yamuna Ltd. invited general public to subscribe for its public issue of ₹ 10 crore (10 lakh shares of ₹ 100 each) through issue of prospectus. However, the company received applications for 8 lakh shares. Can the company proceed with allotment of shares? Give reasons in support of your answer. **(3 marks)**

Answer 4

No, Yamuna Ltd. cannot proceed with allotment of shares as minimum subscription has not been received.

In order to prevent companies from commencing business with inadequate resources, it is provided that a company must receive the amount of minimum subscription in cash. Minimum subscription is 90 per cent of the issued amount (according to SEBI guidelines). Otherwise, the allotment cannot be made and the application money received must be returned to the applicants.



Question 5

A Ltd. was issued Certificate of Incorporation by the Registrar on 10th February 2020. However, the date mentioned on the Certificate was 1st February 2020. The company entered into a contract for purchase of land with B Ltd. on 5th February 2020. Now B Ltd. is not interested to sell the land as it is getting a higher price from another buyer. Can A Ltd. file a case against B Ltd.? Give reasons in support of your answer. **(3 marks)**

Answer 5

Yes, A Ltd. can file a case against B Ltd. as the company was in existence on 5th February 2020. Although wrong date was entered in the certificate, still ‘Certificate of Incorporation’ is a conclusive evidence of regularity of incorporation of a company, irrespective of any deficiency. So the contract is valid and B Ltd. is under a legal obligation to honour the contract.



Question 6

You are a business consultant. Mr. Madanpal has recently retired from government service. He is 60 years old and he wants to set up a factory to manufacture plastic goods. He has come to consult you so that you may suggest to him the most suitable form of business organisation. The following are his main expectations from the business organisation:

- (i) Ease in formation,
- (ii) Flexibility in operations,
- (iii) Sharing of profits with limited persons, and
- (iv) Sufficient persons to look after various business activities.

Question 6

Which form of business organisation will you suggest to Mr. Madanpal? Give reasons in support of your answer.

(3 marks)

Answer 6

‘Partnership’ form of organisation will suit Mr. Madanpal.

Reasons:

- (i) Setting up a partnership firm is quite easier than company organisation.
- (ii) Since the number of partners is limited, operational decisions can easily be changed.
- (iii) In partnership form of organisation, sharing of profits is with limited persons.
- (iv) The availability of persons to look after the different business activities is more than one.

Question 7

Shikha is a sole proprietor. Over the past decade, her business has grown from operating a neighbourhood corner shop selling accessories such as artificial jewellery, bags, hair clips and nail polish to a retail chain with three branches in the city. Although she looks after the varied functions in all the branches, she is wondering whether she should form a company to better manage the business. She also has plans to open branches countrywide.

- (a) Explain two benefits of remaining a sole proprietor.
- (b) Explain two benefits of converting to a joint stock company.

(c) What role will her decision to go nationwide play in her choice of form of the organisation? **(6 marks)**



Answer 7

- (a) Two benefits of remaining a sole proprietor:
- (i) She is the sole recipient of all the profits.
 - (ii) She will have the exclusive control over her business. All the decision can be made by herself without consulting others.
- (b) Two benefits of converting to a joint stock company:
- (i) Her business can mobilise large amount of financial resources from the public as well as through loans from banks and financial institutions. Thus, there will be greater scope for growth and expansion.

(c) If she takes decision to go nationwide, she will have to operate on large scale. In such a case, company organisation is the best choice.

Question 8

All the members of a company sitting in a general meeting were killed by a bomb. Was the company wound up? Explain. **(3 marks)**



Answer 8

No, the company survived. Not even a hydrogen bomb could have destroyed it. A company has perpetual succession. Being distinct from members, the death, insolvency or retirement of its members does not affect the life of the company. Members may come and go, but the company can go forever.



Question 9

A member, who held all shares except one share of a timber company, insured the company's timber in his own name. Can he claim compensation from the insurance company? Explain. **(3 marks)**

Answer 9

No, his claim for compensation will be rejected by the insurance company since a member does not have any insurable interest in the property of the company, even if he acquires all the shares of the company. The company has separate property from the property of its members.

Question 10

Shakti Ltd. issues 1,00,000 shares of ₹ 10 each for public subscription. Application (along with money) are received for 80,000 shares. Can the company allot these shares? Explain. **(3 marks)**

Answer 10

No, the company cannot allot these shares because the legal formality of 'minimum subscription' is not fulfilled. A company must receive the amount of minimum subscription in cash (which is 90% of the issued amount). Otherwise, allotment cannot be made.

In this case, the company has received only 80% of the issued amount. So, it cannot make allotment of these shares and will have to refund all the money received from the applicants.

Question 11

Mr. Aman wants to set up a business organisation. He has two main expectations from the business organisation— (i) Limited Liability and (ii) Continuity.

What form of business organisation is suitable for Mr. Aman? Give reasons in support of your answer.

(3 marks)

Answer 11

Company form of organisation Reasons:

- (i) **Limited Liability:** The liability of the members is limited to the face value of the shares held by them. They are not personally liable to the debts of the company.
- (ii) **Perpetual succession:** Being distinct from the members, the death, insolvency or retirement of its members does not affect the life of the company.

Question 12

A company got its Certificate in Incorporation on 20th August, 2020 and on the certificate the date was written as 10th August, 2020. The company allotted some shares on 18th August. Is the allotment valid or not? Give reason in support your answer. **(3 marks)**

Answer 12

Yes, it is a valid allotment because though the registrar issued the certificate of incorporation on 20th August, 2020 but on the certificate 10th August was written. So in the eyes of law, the company was registered on 10th August as the certificate of incorporation is the conclusive evidence of its legal existence of the company.

Self-Assessment Test 1

Forms of Business Organisation

Time Allowed: 1 hour

Maximum Marks: 25

Question 1

Minimum number of members to form a private company is (*Choose the correct alternative*) **(1 mark)**

- (a) 2
- (b) 3
- (c) 5
- (d) 7

Question 2

Application for approval of name of a company is to be made to *(Choose the correct alternative)*

(1 mark)

- (a) SEBI
- (b) Registrar of Companies
- (c) Government of India
- (d) Government of the State in which Company is to be registered

Question 3

A proposed name of Company is considered undesirable if *(Choose the correct alternative)*

(1 mark)

- (a) It is identical with the name
- (b) It resembles closely with of an existing company the name of an existing company
- (c) It is an emblem of Government
- (d) In case of any of the above of India, United Nations etc.

Question 4

A prospectus is issued by

(Choose the correct alternative) **(1 mark)**

- (a) A private company
- (b) A public company seeking investment from public
- (c) A public enterprise
- (d) A public company

Question 5

Briefly explain three activities which can be suitably undertaken by cooperative societies. **(3 marks)**

Answer 5

Following are the activities undertaken by cooperative societies:

- (i) A cooperative society may undertake the construction of houses/flats for its members at lower costs and giving the option of paying in instalments. (Cooperative housing societies)
- (ii) A cooperative society may undertake the provision of easy credit on reasonable terms to the members at low interest rates. (Credit cooperative societies)
- (iii) A cooperative society may undertake the sale of the products of its members at reasonable prices. (Marketing cooperative societies)

Question 6

“Karta is the most active member in a Joint Hindu Family Business. He is too powerful to ruin the business.”
Comment. **(3 marks)**

Answer 6

Karta is the most active member in a Joint Hindu Family Business. The right to manage the business vests in Karta alone. He has the implied authority to obtain loans through mortgages, etc. for the purpose of the business. His decisions are binding on other members. Other members have neither any right to manage the affairs of business nor any right to take loans on mortgage of business property.

But if Karta is inefficient and incapable for managing the business, he may ruin the business. The decisions of such a person (Karta) may not be acceptable to other members, which may cause conflicts, resulting in the break-down of the family business.

Question 7

Aditya is promoting a company. Before the company is formed, he enters into a contract with DLF for purchase of land and also agreed to pay 10 crores within a period of 2 months. The company was formed within 1 month. On the basis of the facts, answer the following :-

- (i) Which type of contract is entered by Aditya ?
- (ii) Is the contract legally binding on the company ?
- (iii) Can DLF Ltd. hold Aditya liable for the payment money?
- (iv) What can the company do to prevent Aditya from such a situation?

(4 marks)

Question 8

Explain the steps taken by promoters in the promotion of a company. **(5 marks)**

Question 9

“One man control is best in the world if that one man is big enough to manage everything.” Explain the statement. **(6 marks)**

Answer 9

“One man control is best in the world if that one man is big enough to manage everything” —W.R. Basset.

These advantages are as follows:

- (i) It requires less amount of capital.
- (ii) Ease of formation and closure of business.
- (iii) Quick decision making without consulting others.
- (iv) Confidentiality of information.
- (v) A sole proprietor is the sole recipient of all the profits.
- (vi) Flexibility of operations because all decisions



are made by a single person.

These advantages are available provided the man is capable of managing everything. In real life such a person does not exist. A person may be a rich engineer but he may lack financial ability. Therefore, one man business suffers from several limitations:

- (i) Limited financial resources and limited scope for expansion.
- (ii) Limited life of a business concern, depending on the life of the owner.
- (iii) The sole proprietor has unlimited liability.

(iv) Limited managerial ability

Though sole proprietorship suffers from various shortcomings, many entrepreneurs opt for this form of organisation because of its inherent advantages. It requires less amount of capital. It is best suited for businesses which are carried out on a small scale and where customers demand personalised services.

Self-Assessment Test 2

Forms of Business Organisation

Time Allowed: 1 hour

Maximum Marks: 25

Question 1

Minimum number of members to form a public company is *(Choose the correct alternative)* (1 mark)

(a) 5

(b) 7

(c) 12

(d) 21

Question 2

Stages in the formation of a public company are in the following order:

(Choose the correct alternative) (1 mark)

- (a) Promotion, Commencement
- (b) Incorporation, Capital of Business, Capital Subscription, Promotion Subscription, Incorporation
- (c) Promotion, Incorporation
- (d) Capital Subscription Capital Subscription, Promotion, Incorporation,

Question 3

Preliminary Contracts are signed

(Choose the correct alternative) **(1 mark)**

- (a) Before the incorporation
- (b) After incorporation but before capital subscription
- (c) After incorporation but before commencement of business business
- (d) After commencement of commencement of business business

Question 4

It is necessary to get every company incorporated, whether private or public. (*True/False*) **(1 mark)**

Question 5

The business assets of a firm are worth ₹ 2,00,000 but the debts remain unpaid are worth ₹ 3,00,000. What course of action can the creditors take in the following cases?

- (a) The organisation is a sole proprietorship firm.
- (b) The organisation is a partnership firm with A and B, two partners sharing profit equally. **(3 marks)**

Answer 5

- (a) The creditors may claim from the personal property of the proprietor as he has unlimited liability.
- (b) A and B are jointly and individually liable to repay the firm's debts in their profit sharing ratio, i.e., 1:1; and if one of the partners becomes insolvent then the other is liable to repay the whole debt.

Question 6

Compare the status of a minor in a Joint Hindu Family Business with that in a partnership firm. **(3 marks)**

Answer 6

A minor is a person who has not attained the age of 18 years.

- In a Joint Hindu Family Business, membership is by birth. Therefore, minors can also be members of the business.

The liability of minor is limited to his share in the business. They have to share losses also.

- In a partnership firm, a minor cannot become a partner because he is not capable of entering into a valid agreement. However, a minor can be admitted to the benefits of an existing partnership



firm with the mutual consent of all other partners. He cannot be asked to bear the losses.

Question 7

The business assets of an organisation amount to `50,000 but the debts that remain unpaid are `80,000. What course of action can the creditors take if

- (a) The organisation is a sole proprietorship firm
- (b) The organisation is a partnership firm with Anthony and Akbar as partners. Which of the two partners can the creditors approach for repayment of debt? Explain giving reasons. **(4 marks)**

Question 8

Dhirubhai Chaurasiya operates a textile business. His family is joint and has a lot of ancestral property. All the 15 family members are a part of this business. He is the eldest male member in the family so he heads the business. He is liable to all the creditors of the business as he is the decision maker. Dhirubhai's grandson has just born a few days ago and he is also the member of the business.

- (a) Which form of business is being undertaken by Dhirubhai Chaurasiya ?
- (b) Identify the features of this form of business based on the information given.



(c) Textile business is part of which type of industry according to you ? **(5 marks)**

Question 9

The owner of a general store wants to open a branch in a nearby town. Will you advise him to take a partner to run the branch store or employ a manager/assistant? Give reasons for your advice.

(6 marks)

Answer 9

Since the owner of the general store (sole proprietorship business) wants to expand his business by opening a branch in a nearby town, he may appoint a salaried manager/assistant or may take a partner.

Employment of salaried manager/assistant

Advantages

- (i) Division of work: The proprietor can delegate duties to the manager/assistant according to his ability and experience. In this way, the burden



of work on the proprietor is reduced. He can devote more time and attention on key issues.

(ii) Centralised control and freedom of decision-making: The proprietor has full control over the business. He is free to decide business policies without any interference from the manager/assistant.

(iii) No profit sharing: The proprietor is the sole recipient of all profits as the manager/assistant is appointed on salary.

Admitting a partner

Advantages

- (i) More financial resources: By taking a partner, the problem of capital will be solved.
- (ii) Division of work: Work can be divided among partners according to their skills and experience.
- (iii) Joint liability: Both the partners will be jointly liable to the firm's debts.

Conclusion: The choice between salaried manager/assistant and partner will depend upon the type of assistance required by the owner of the general store.

- 
- If he requires additional capital for the purpose of expansion of business as well as managerial assistance, and is interested in sharing of risk, taking a partner will be a better choice.
 - But if he himself can arrange more capital, needs someone to share his managerial duties only and is ready to bear entire risk, then it is better to employ a salaried manager/assistant.

Self-Assessment Test 3

Unit-1 and Unit-2

Time Allowed: 1 hr. 30 min.

Maximum Marks: 40

Question 1

The structure in which there is separation of ownership and management is called

(Choose the correct alternative) **(1 mark)**

- (a) Sole proprietorship
- (b) Partnership
- (c) Company
- (d) All business organisations

Question 2

The karta in Joint Hindu family business has

(Choose the correct alternative) **(1 mark)**

- (a) Limited liability
- (b) Unlimited liability
- (c) No liability for debts
- (d) Joint liability

Question 3

Preliminary Contracts are _____. (binding on the Company, if ratified after incorporation/not binding on the Company, after incorporation Company)

(Fill up the blank with correct answer) (1 mark)

Question 4

Statement in lieu of prospectus can be filed by a public company going for a public issue.

(True/False) **(1 mark)**

Question 5

ABC Ltd. Is planting a tree on roadside. Which objective it is trying to achieve? **(1 mark)**

Question 6

Why is the insurance known as a tertiary industry?

(1 mark)

Question 7

A lawyer is working in a knowledge process outsourcing (KPO) organization. What type of economic activity is he performing ? **(1 mark)**

Question 8

Shiv, Anandi & John were partners John died in a car accident Both Shiv & Anandi decided to admit his son Ryan who was 16 years old as partner. Can they do so ? Justify. **(3 marks)**

Answer 8

Minor as a partner

Question 9

Categories the following into business, profession and employment:

(i) A farmer (ii) An advocate (iii) A clerk (iv) A hawker selling toys for children (v) A doctor (vi) A person repairing scooter on roadside

(3 marks)

Question 10

Comment on the following :

- (i) Meeting of X Ltd. was going on in which all the members of the company were present suddenly a natural calamity occurred and all the members of the company X Ltd. died. What would happen to the existence of the company 'X' Ltd. Why?
- (ii) The company being an artificial person acts through its Board of Directors. All the agreements on behalf of the company are entered by the Board of Directors. When is an agreement entered by the Board of directors not legally binding on the company.

(4 marks)

Question 11

Different situations in different business are being elaborated below:

- (i) Raghunath Gorkha had a match stick factory in Nepal which got distructed by the recent earthquake.
- (ii) Mr Arya. a senior manager in a telecom company shared confidential information about the company with a competitor which led to huge losses for the company.
- (iii) Vodafone Co was charged with evasion of tax and asked to pay fine in cross which would lead to heavy losses for the company.

- 
- (iv) Type writers becoming redundant because of laptops.
- (a) Which characteristic of business is being referred to in all the above cases ?
- (b) How can you classify the different cases based on this characteristic ? **(4 marks)**

Answer 11

[Hint : Business Risks - Causes]

Question 12

Rahul and Sanchali felt that there was an opportunity of business in providing a service of online grocery stores for working people. They analysed the idea in terms of technical, financial and economic liability. Once they found all the aspects satisfactory they decided to start a company called 'convenience @ home' private Ltd. They got the name registered with the registrar.

- (a) Which steps of formation of company are being referred to here ?
- (b) Also write the next three steps associated with it.

(5 marks)

Answer 12

[Hint : steps in promotion of a company]

Question 13

Commerce is the sum total of activities that remove hindrances in the free flow of goods from producers to consumers. Explain. **(5 marks)**

Question 14

What is meant by the term 'Promotion'. Discuss the legal position of promoters with respect to a company promoted by them. **(6 marks)**