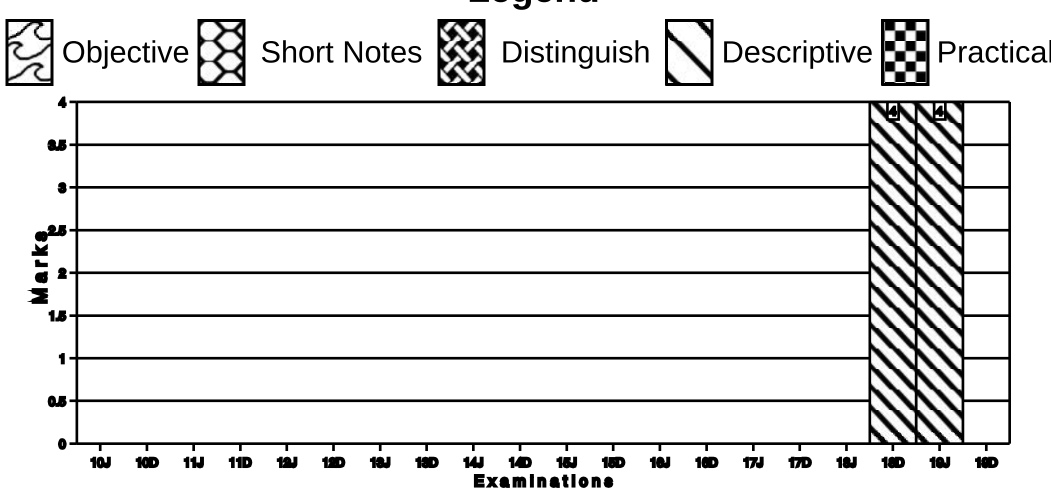
1 CHOICE OF BUSINESS ORGANISATION

THIS CHAPTER INCLUDES

- Choice of a business organisation
- Factors governing the decisions for suitable form of organisation
  - Nature of business activity
  - Scale of operations
  - Capital requirements
  - Managerial Ability
  - Degree of control and management
  - Degree of risk and liability
- Stability of business
- Flexibility of administration
- Division of profit
- Costs, procedure, and government regulation
- Tax implication
- Geographical mobility
- Transferability of ownership
- Managerial Needs
- Secrecy
- Independence

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend



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CHAPTER AT A GLANCE

Choice of a Business Organisation
The choice of a business entity will depend on an object, nature and size of the business of such entity which will be varied from case-to-case basis and will also depend upon the will of the owners of the business entity which they want to accomplish. The main types of business entities in India are Sole Proprietorship, Partnership, Hindu Undivided Family (HUF) Business, Limited Liability Partnership (LLP), Co-operative Societies, Branch Office and Company which may be any kind of company including one person company (OPC), private limited company, public limited company, guarantee company, subsidiary company, statutory company, insurance company or unlimited company. Further, Company formed under section 8 of the Companies Act, 2013.
Factors governing the decisions for suitable form of organisation
1. Nature of Business Activity: This is an important factor having a direct bearing on the choice of a form of ownership. In small trading businesses, professions, and rendering of personal services , sole-proprietorship is predominant. **2. Scale of Operations:** The second factor that affects the form of business organisation is the scale of operations. If the scale of operations of business activities is small, sole proprietorship or a One Person Company (OPC) is suitable; if the scale of operations is modest – neither too small nor too large – partnership or limited liability partnership (LLP) is preferable; whereas, in case of large scale of operations, the company form is advantageous. **3. Capital Requirements:** Capital is one of the most crucial factors affecting the choice of a particular form of ownership organisation.

Requirement of capital is closely related to the type of business and scale of operations. Enterprises requiring heavy investment (like iron and steel plants, large scale infrastructure projects, etc.) should be organised as companies.

4. **Managerial Ability:**
It is difficult for a sole proprietor to have expertise in all functional areas of business. Further, the size of the business may not permit engagement of professional management.

5. **Degree of Control and Management:**
The degree of control and management that an entrepreneur desires to have over business affects the choice of form of organisation. In sole proprietorship and OPC, ownership, management, and control are completely fused, and therefore, an entrepreneur has complete control over his business.

6. **Degree of Risk and Liability:**
The size of risk and the willingness of owners to bear it, is an important consideration in the selection of a form of business organisation. The amount of risk involved in a business depends, among other factors like, on the nature and size of business. Smaller the size of business, smaller the amount of risk.

7. **Stability of Business:**
Stability of business is another factor that governs the choice of an ownership organisation. A stable business is preferred by the owners in so far as it helps him in attracting suppliers of capital who look for safety of investment and regular return, and also helps in getting competent workers and managers who look for security of service and opportunities of advancement.

8. **Flexibility of Administration:**
As far as possible, the form of organisation chosen should allow flexibility of administration. The flexibility of administration is closely related to the internal organisation of a business, i.e., the manner in which organisational activities are structured into departments, sections, and units with a clear definition of authority and responsibility.

9. Division of Profit:

Profit is the guiding force of private business and it has a tremendous influence on the selection of a particular form of business organisation. An entrepreneur desiring to pocket all the profits of business will naturally prefer sole proprietorship.

10. Costs, Procedure, and Government Regulation:

This is also an important factor that should be taken into account while choosing a particular form of organisation. Different forms of organisation involve different procedure for establishment and are governed by different laws which affect the immediate and long-term functioning of a business enterprise. From this point of view, sole proprietorships are the easiest and cheapest to get started.

11. Tax Implication:

In the choice of the form of business organisation, tax implication plays an important factor. In smaller entities, such as sole proprietorship or partnership, tax liability is dependent on the extent of profits.

However, the liability of the owner(s) is unlimited. In case of companies or LLPs the liability of shareholders is limited to the value of shares they have purchased. In case of companies or LLPs, tax liability could be higher.

(a) Sole Proprietorship:

Proprietor's age is less than 60 years

Taxable income	Tax Rate
Up to ₹ 2,50,000	Nil
₹ 2,50,000 to ₹ 5,00,000	5%
₹ 5,00,000 to ₹ 10,00,000	20%
Above ₹ 10,00,000	30%

Proprietor's age is between 60 and 80 years

Taxable income	Tax Rate
Up to ₹ 3,00,000	Nil
₹ 3,00,000 to ₹ 5,00,000	5%
₹ 5,00,000 to ₹ 10,00,000	20%
Above ₹ 10,00,000	30%

Proprietor's age is above 80 years

Taxable income	Tax Rate
Up to ₹ 5,00,000	Nil
₹ 5,00,000 – ₹ 10,00,000	20%
Above ₹ 10,00,000	30%

(b) Partnership firm:

Partnership firms in India can be divided into two categories namely, registered partnership or unregistered partnership. Registered partnership firms are those firms having a registration certificate from the Registrar of Firms. All other partnerships that do not have a registration certificate would be classified as an unregistered partnership firm.

(c) Domestic Company:

Net Profit of a domestic company (including a Limited Liability Partnership to which the Income Tax rates for domestic companies is applicable) is taxable at 30%. However, tax rate is 25% if turnover or gross receipt of the company does not exceed ₹ 250 crore. In addition, there is:

(a) Surcharge at 7% of tax where total income exceeds ₹ 1 crore and below ₹ 10 Crores and 12% of tax where total income exceeds ₹ 10 crores and

(b) Health and Education cess = 4%

(d) Co-operative Society:

The tax rate is 10% for taxable income upto ₹ 10,000, 20% for taxable income between ₹ 10,000 to ₹ 20,000 and 30% for taxable income above ₹ 20,000. In addition, there is:

(a) Surcharge at 12% of tax where total income exceeds ₹ 1 crore; However, the surcharge shall be subject to marginal relief (where income exceeds one crore rupees, the total amount payable as income-tax and surcharge shall not exceed total amount payable as income-tax on total income of one crore rupees by more than the amount of income that exceeds one crore rupees).

(b) Health and Education society = 4%

12. Geographical Mobility:
The extent to which the product or service is proposed to be manufactured or made available also plays a vital role in choosing the type of business organisation. If a concern deals with local market, a seasonal product or perishable goods, or is meant to cater to a specific city or locality, then sole proprietorship or partnership form of business may be suitable.

13. Transferability of Ownership:
Sole proprietorship, being a one-person entity does not lend itself to transferability of ownership as the owner himself enjoys the profits and suffers the losses in his business. Partnership form of organisation is one where two or more partners share the profits and/or losses in the agreed proportion.

14. Managerial Needs:
Managerial and administrative requirements also affect the decision about the form of organisation. When the concern is small and it caters to local needs only then one person will be enough to manage the business. Sole – proprietorship form of organisation will be suitable for such a business.

15. Secrecy:
Secrecy is of supreme importance, particularly in small business concerns. Accordingly, the entrepreneur would select the sole proprietorship for that reason. In case, he has partners, he will have to carefully weigh whether other partners will be able to maintain the secrecy.

16. Independence:
The company is subject to strict government regulations. So, if the entrepreneur wants to have a freedom in business with little governmental interference, he has to go for either sole proprietorship or partnership.

DESCRIPTIVE QUESTIONS

2018 - Dec [2A] (Or) (i) Ankur has passed out MBA from a premier institution. He wants to become an entrepreneur but he is confused in choosing the form of ownership. Advise Ankur on the aspects which he should consider before deciding the form of ownership. **(4 marks)**

Answer:

One of the first decisions that is faced by an entrepreneur is how the business should be structured. All businesses must adopt some legal configuration that defines the rights and liabilities of participants in the business's ownership, control, personal liability, life span and financial structure.

This decision will have long term implications, so he has to select the form of ownership that is right for him.

In making a choice, he (in our case, Ankur) should take into account the followings:

- His vision regarding the size and nature of business;
- The level of control he wishes to have;
- The level of structure", he is willing to deal with;
- The business's vulnerability to litigation;
- Tax implications of the different organizational structures; Expected profit or loss of the business;
- Whether or not, he will need to re-invest earnings into the business; and His need for access to cash out of the business for himself.

—— Space to write important points for revision ——

2019 - June [2A] (Or) Comment on the following:

(iv) Requirement of Capital affects the choice of suitable form of a business organization. **(4 marks)**

Answer:

- Capital is one of the most crucial factors affecting the choice of a particular form of ownership of an organization.
- Requirement of capital is closely related to the type of business and scale of operations. Enterprises requiring heavy investment (like iron and steel plants, large scale infrastructure projects, etc.) should be organized as companies.
- Depending on the capital required, they can be set up as public companies and in some cases, may be in the form of listed companies by raising money from the public and being listed on the stock exchanges.
- Enterprises requiring small investment (like retail business stores, personal service enterprises, etc.) can be best organized as sole proprietorships or even as Partnerships.
- Apart from the initial capital required to start a business, the future capital requirements — to meet modification, expansion, and diversification plans — also affect the choice of form of organization.
- In sole proprietorship, the owner may raise additional capital by borrowing, by purchasing on credit, and by investing additional amounts himself. Banks and suppliers, however, will look closely at the proprietor's individual financial resources before sanctioning any loans or advances.
- Partnerships can often raise funds with greater ease, since the resources and credit of all partners are combined in a single enterprise. Companies are usually best able to attract capital because investors are assured that their liability will be limited, their operations are in public domain in a transparent manner, easily accessible and the ownership can be transferred to other investors.

TOPIC NOT YET ASKED BUT EQUALLY IMPORTANT FOR EXAMINATION

SHORT NOTES

Q1. Write short note on Co-operative organisation.

Answer:

Corporate Form of Business Enterprises:

The Co-operative Organisation: Co-operative organisation is a voluntary association with unrestricted membership and collectively owned funds, organised on democratic principle of equality by persons of moderate means and incomes, who join together to supply their needs and wants through mutual action, in which the motive of production and distribution is service rather than profit. Besides being a form of ownership Co-operative organisations are a means of protecting the interests of the relatively weaker sections of society against exploitation by big businesses operating for the maximisation of profits. The basic feature which differentiates the Co-operative organisation from other form of business enterprises is that its primary motive is service to the members rather than making profits. A Co-operative society is required to be registered under the Co-operative Societies Act, 1912. The co-operative societies receive a number of special concessions from the law and the Government, in order to encourage healthy development of Co-operatives.

—— Space to write important points for revision ——

Q2. Write short note on Domestic Company.

Answer:

Domestic Company:

Net Profit of a domestic company (including a Limited Liability Partnership to which the Income Tax rates for domestic companies is applicable) is taxable at 30%. However, tax rate is 25% if turnover or gross receipt of the company does not exceed ₹ 50 crore. In addition, there is:

(a) Surcharge at 7% of tax where total income exceeds ₹ 1 crore and below ₹ 10 crores and 12% of tax where total income exceeds ₹ 10 crores.

(b) Health and Education cess = 4%

—— Space to write important points for revision ——

DISTINGUISH BETWEEN

Q1. Distinguish between a sole proprietorship and partnership.

Answer:

1. Sole Proprietorship:

In this form of business organisation, an individual normally uses his own capital, skill and intelligence to carry out some business activity. He is entitled to receive all the profits and gains of his business and also assumes all the risk of ownership. The sole proprietor exercises full control over the affairs of his business. As there is no legal obligation to supply any information regarding his business to anyone, he can maintain maximum secrecy in conducting his business affairs. This type of organisation is particularly suitable for businesses which are small in size and where risk and capital involved are not very large.

2. Partnership:

In this form of organisation, few like-minded persons pool up their resources to form a partnership firm. Section 4 of the Partnership Act, 1932, defines partnership as "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". This definition chiefly brings out the following features of partnership:

(i) Contractual Relationship:

Since partnership arises out of agreement between persons, only those persons who are competent to contract can be partners.

(ii) Existence of business:

There can be no partnership without business. The persons who have agreed to become partners must carry out some business activity.

(iii) Sharing of profits:

The agreement to carry on business must be entered into, with the object of making a profit and sharing it among all the partners.

(iv) Mutual agency:

The business must be carried on by all the partners or by any one or more of them acting for all the partners. Thus each partner is both an agent and a principal for all other partners.

Space to write important points for revision

DESCRIPTIVE QUESTIONS

Q1. What are the factors which govern the choice of a business organisation?

Answer:

Factors Governing the Decisions for Suitable form of Organisation:

1. **Nature of Business Activity:**

   This is an important factor having a direct bearing on the choice of a form of ownership. In small trading businesses, professions, and rendering of personal services , sole-proprietorship is predominant.

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