

Economics, Management and Entrepreneurship
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Lecture – 47
Forms of Ownership

Good morning. Welcome to the 47th lecture on Economics, Management and Entrepreneurship. So long in our previous 46th lectures, we had discussed various aspects of microeconomics, engineering economy, costing and accounting and various functions of management and different aspects of managerial functions. Marketing management was the last topic that we had taken. There are still a few more topics that should have been considered in management.

In particular, we could have devoted 1 or 2 lectures each on quality and productivity, human resource management and project management. Unfortunately, the number of lectures is growing beyond bounds. I wish to keep the total number of lectures limited to 50. Keeping that in mind, I have decided to devote today's lecture and the next 3 lectures on different aspects of forming business, sourcing capital, and other aspects of entrepreneurship.

These 4 lectures today and the next 3 lectures taken together will be very important for someone who is actually interested to start a new business in Indian conditions. Today, we shall discuss various forms of ownership that are legally accepted in India. So that is the topic for today, forms of ownership.

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Forms of Ownership

- Sole Proprietorship
- Partnership Firm
- Joint Hindu Family Business
- Cooperatives
- Private Limited Company
- Public Limited Company
- Limited Liability Partnership
- Companies within Section 25 of Companies Act, 1956
- Franchise



There are different forms of ownership that are legally recognised in India. These are different forms: sole proprietorship, partnership, joint Hindu family business, co-operatives, private limited company, public limited company, limited liability partnership, companies within section 25 of Companies Act 1956, and franchise.

So these are different forms of ownership that are recognised by the Indian government and we shall devote some time on each of these forms of ownership. So there are altogether 1 2 3 4 5 6 7 8 and 9. This last 2 you will see that they are covered under the previous ones but I separately wrote them because they have some distinctive characteristics. Let us study each one separately. (Refer Slide Time: 04:56)

Sole Proprietorship

- It is a one-person organization
- No legal formalities
- License specific to the line of business from the local administration may be required
- No legal existence separate from its owner
- **Unlimited liability** of the proprietor
- Lack of continuity
- Suitable for businesses which involve moderate risk, small financial resources, and small capital requirement



Sole proprietorship. As the name indicates, it is a one-person organisation. A single person can start a business and then he becomes the proprietor and the form of organisation is the sole proprietorship type of organisation. Now there are no legal formalities to start such a business. However, one needs to have licenses from local authorities such as municipality or panchayat or similar such local organisation to start the business, to start the line of business.

So that is important from the local administration. This license is very important. Now there is no legal existence separate from its owner because it has no legal formalities excepting for the license. So if anything happens, the owner is liable. In fact it is a case of unlimited liability of the proprietor. That means if the proprietor takes loan to run its business, then he is completely liable for paying off the debts.

If the business winds up, then the person, the owner itself, the proprietor himself or herself, is completely liable to pay the debts in case the company winds up. Naturally since the owner is the main person, the only person in the business, if he or she dies, the business comes to an end and this form of business is suitable when the risk is low to medium, requires very little financial resource and small capital requirement, only for such purposes sole proprietorship type of business may be appropriate.

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Partnership

- Defined as a relation between two or more persons who have agreed to share the profits of a business carried on by all of them or any of them acting for all.
- The owners of a partnership business are individually known as the "**partners**" and collectively as a "**firm**".
- Its registration is also not essential.
- The **Registrar of Firms** is responsible for registering partnership firms.
- Minimum number of partners is 2 and the maximum is 10 (for banking business) and 20 (for other types of business).
- No separate legal existence of its own, i.e., the firm and the partners are one and the same in the eyes of law.



Then we take up the next form of business, the partnership type of business. It is basically

defined as a relation between 2 or more persons who agree to share the profits of a business carried on by all of them or any of them acting for all. So that is the definition of partnership. It is basically an agreement among 2 or more persons and not all of them may be involved actively in running the business on their behalf.

If you want or more may carry out or carry on the normal activities. The owners of a partnership business are individually known as partners and collectively the business is called a firm. So this is therefore a partnership firm. Although sometimes loosely we use the word firm to mean a company. Legally it is a firm only when it is a partnership type of business. Now this agreement, its registration is also not essential, that means the agreement need not be registered or the partnership firm need not be registered.

However, if it is desired that such a firm is registered because there may be certain disputes among the partners in the future; therefore, in their own interest, they may like to register the firm, then it has to be done with the registrar of firms. If at all such a registration is made by the partners, then they will have to register it with the register of firms which is available in every state.

The minimum number of partners is 2 and the maximum can be either 10 or 20. 10, if it is a business, if it is a banking business and 20, any other type of business but the minimum can be 2. Maximum can, as I said, 10, can be 10 or 20. Again unless it is registered with the registrar of firms, it has not separate legal existence and the firms and the partners are the one and the same in the eyes of law. So if anything, a case is registered against firm and the case is actually registered against the partners forming the firm. So this is a partnership type of ownership.

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- **Unlimited liability** of the partners
- No partner can transfer his interest in the firm to any person (except to the existing partners) without the unanimous consent of all other partners.
- The firm has a **limited span of life** i.e. legally, the firm must be dissolved on retirement, lunacy, bankruptcy, or death of a partner.
- A partnership is formed by an agreement, which may be either written or oral. When the written agreement is duly stamped and registered, it is known as "**Partnership Deed.**" THE INDIAN PARTNERSHIP ACT, 1932 applies.
- Partnership is appropriate for **medium sized business** involving limited capital. This may include small scale industries, wholesale and retail trade; small service concerns like transport agencies, real estate brokers; professional firms like chartered accountants, doctors' clinic, attorney or law firms.



Now here just as the sole proprietors, in a sole proprietorship type of organisation, is completely liable for any financial payoff, similarly partners in a partnership type of organism also have unlimited liability. That means if the firm takes a big loan and if the firm wind of because of financial insolvency, then the partners have to pay back the debt from their own personal property, that is unlimited liability.

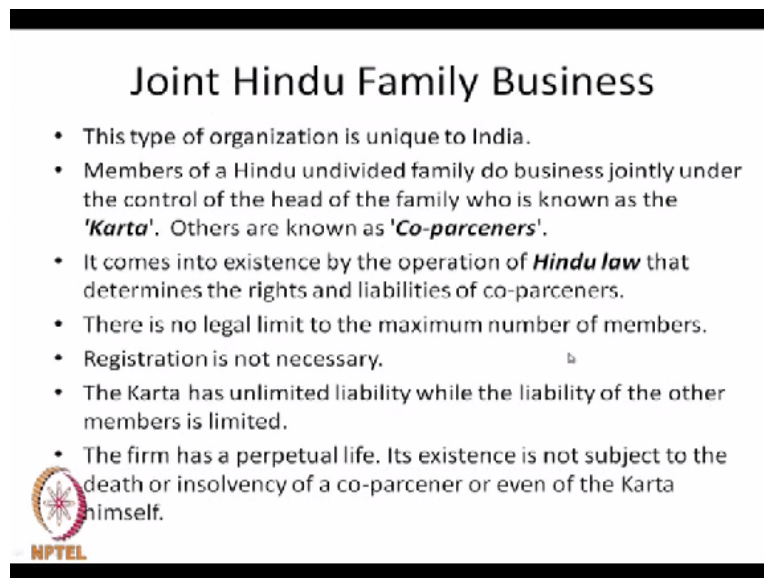
No partner can transfer his or her interest in a firm to any other person excepting to the existing partners without the unanimous consent of all partners. So if everybody else agrees, then only a partner can transfer his interest to another person, else not. Just as continuity is not guaranteed in sole proprietorship, similarly in a partnership type of organisation, continuity is also not guaranteed.

It has a limited span of life. Legally, it must be dissolved on retirement, lunacy, bankruptcy, or death of a partner. Therefore, the continuity is not guaranteed. When a partnership is formed by an agreement, it may be either written or oral and such an agreement as I said need not be registered. If the partners agree to register such an agreement to form the firm, then this must be duly stamped and registered and is known as partnership deed and that is done with the register of firms and there the Indian partnership act 1932.

All the clauses will apply and the formalities have to be gone through. Now partnership type of


organisation is appropriate for medium-sized business that involve not very large amount of capital and this may include small-scale industries, wholesale and retail trade, small service concerns like transport agencies, real estate brokers and even professional firms like chartered accountancy or chartered accountants, doctors clinic, or attorney or law firms. So these are the areas in which partnership firms are found to be very suitable.

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Joint Hindu Family Business

- This type of organization is unique to India.
- Members of a Hindu undivided family do business jointly under the control of the head of the family who is known as the '**Karta**'. Others are known as '**Co-parceners**'.
- It comes into existence by the operation of **Hindu law** that determines the rights and liabilities of co-parceners.
- There is no legal limit to the maximum number of members.
- Registration is not necessary.
- The Karta has unlimited liability while the liability of the other members is limited.
- The firm has a perpetual life. Its existence is not subject to the death or insolvency of a co-parcener or even of the Karta himself.



Now in India, we have another form of organisation, that is known as Joint Hindu family Business. This type of organisation is unique to India because of its historicity. Here what happens, the members of a Hindu undivided family do business jointly under the control of the head of the family who is known as Karta and others are known as co-parceners. Now under the Hindu law, such a form of organisation comes into existence and is recognised by the Hindu law of the country and according to the various provisions, the rights and liabilities of the co-parceners are determined.

Now there is no legal limit to the maximum number of members. Legally there is not an upper limit, no upper limit and also registration is not necessary and thus Karta who is the head of the family and of the business has unlimited liability. While the liability of the other members that is co-parceners, co-parceners is limited. So Karta has unlimited liability, that means in case of financial insolvency and dissolution of the business, Karta from his own personal property has to meet the debt.

The firm of course has a perpetual life and its existence is not subject to the death or insolvency of a co-parcener or even of the Karta himself. That is because it is an Hindu undivided family, so if Karta dies, someone else becomes the Karta and others continue to live and therefore the business is headed by another person who now becomes the Karta and of course other members of the family act as co-parceners and the family business continues. These are the characteristics of Joint Hindu Family type of business.

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Cooperative

- It is a **society** – a voluntary association of 10 or more members, who join together on the basis of equality.
- Primary objective is to serve members rather than make profits.
- Different types of cooperatives like consumer co-operatives, producer's co-operatives, marketing co-operatives, housing co-operatives, credit co-operatives, farming co-operatives etc.
- A member is free to leave the society.
- It has to register with the **Registrar of Co-operative Societies** (Co-operative Societies Act, 1912 or State Co-operative Societies Acts).
- The **liability of a member is limited** to the extent of his capital contribution.
- The shares cannot be transferred but can be returned to the society in case a member wants to withdraw his membership.
- It enjoys continuity of existence.

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Then we come to another form of business and they are the co-operatives. Cooperative is basically a society, a voluntary association of 10 or more members. That means a minimum number of members has to be 10, there can be many more who join together on the basis of equality, that means every member has got equal rights in the running of the cooperative and it is voluntary.

The primary objective of such a business is service to the members, is to serve members rather than make profits. So that is the primary objective of a cooperative to provide service to its members and there are different types of co-operatives that exist in our country: consumer cooperative, producers cooperative, marketing cooperative, housing cooperatives, credit cooperatives, farmers cooperatives and so on.

A member of a cooperative is free to leave the society whenever he or she wishes and every such cooperative has to register with the registrar of co-operative societies whose office is available in every state under the co-operatives societies act 1912 or the state cooperative societies act in every state. So such a form of organisation has to register itself with the registrar of cooperative society.

Every member pays an amount to become a member and therefore the liability of the member is limited to the extent of his capital contribution when he became a member. For example, if a person becomes a member of a cooperative society by paying Rs. 100, then in case of financial insolvency of the cooperative, the person loses maximum of Rs. 100, the amount that he had paid as capital contribution, his contribution to become a member of the cooperative.

The shares cannot be transferred but can be returned to the society in case a member wants to withdraw his membership and thus cooperative enjoys a continuity of its existence, members may come and go but the cooperative continues. So these are different aspects or characteristics of cooperative societies.

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Private Limited Company

- It is a voluntary association of 2 – 50 members.
- Liability of a member is limited.
- Transfer of shares is limited to its members.
- Not allowed to invite public subscription for its shares or debentures.
- An independent legal existence. (The Indian Companies Act, 1956).
- It has to register with **Registrar of Companies**.
- It need not file a prospectus with the Registrar.
- It need not obtain the Certificate for Commencement of business.
- Need neither hold statutory general meeting nor file any report.
- The liability of its members is limited.
- It enjoys continuity of existence.
- Preferred by those who wish to take the advantage of limited liability but at the same time desire to keep control over the business within a limited circle and maintain the privacy of their business.

Now we come to another form of organisation. It is called Private Limited Company. You will see the word limited is present and private is present and company of course. Now what it is. A private limited company is basically a voluntary association of a minimum of 2 members and a

maximum of 50 members. So a company will have between 2 to 50 members, a private limited company.

As the name indicates, a member has got limited liability. Let me tell you that limited liability means that every member pays an amount to become part owner of the company and in case of insolvency, the amount that he has given may be forfeited. So the maximum liability of the member is the amount that he has given as his contribution when the company was formed and it is limited because he might have given let us say Rs. 10 lac, then his liability is limited to Rs. 10 lac.

Here the transfer of shares is limited to its own members, members of the company. If there are 10 members, a particular member wishes to transfer his share, then he can do so only to another member not to an outsider. Such a company is not allowed to invite public subscription for its shares or debentures. You might have seen in different papers companies asking for public subscription of its shares or debentures, that is not possible for private limited companies.

A company, private limited company cannot get money from public. It has to get only from its own members as long as it is < 50. Now a company such as this has an independent legal existence. That means it has to register and in fact, it registers with the registrar of companies. I am sorry there is a mistake, this has to be registrar of companies. Under the Indian Companies Act 1956, such a company has to register with the registrar of companies and therefore, it has a legal existence and it has an independent legal existence.

The meaning of independent is that such a body is an independent entity, such a company is an independent company, independent entity and is different from its owners or from its members. That means if let us say somebody files a case against the company, it has to be against the company and not against the members of the company or the owners of the company. Now it need not file a prospectus with the registrar of the companies.

We will discuss about filing a prospectus. The prospectus basically says what are the different prospects, what the company wishes to do, what are its opportunities, what are its plans and

programs for the future. This is basically giving a status, both present and future ambitions of the company. This is normally done if a company wishes to get money from the public and that is done in a public limited company and not a private limited company and therefore, a private limited company need not file a prospectus with the registrar and also need not obtain a certificate to commence business.

This is required for a public limited company as we shall discuss a few minutes later. Although it has to register with the registrar of companies, it need not file a prospectus with the register of the companies and need not obtain a certificate to commence business from the registrar of the companies. Now they also do not need to hold statutory general meeting, nor file any report with the registrar.

These are required for public limited companies because they get, the owners are the public, many from public that the owners therefore, they have to statutory hold general meeting of its owners or shareholders but it is not require for private limited companies. Nor the private limited companies need to file any report to the or with the registrar of companies. Already I have told liability of a member is limited.

Same thing is written here. It enjoys continuity of existence, it means that a member may die, may withdraw but the company continues. So there is a continuity of its existence. Such a form of organisation is preferred by those who wish to take advantage of limited liability because everybody, every owner wishes to have only limited liability to the extent of his contribution while formation of the company is going on.

But at the same time, desires to keep control over the business within a limited circle and maintain certain amount of privacy of the business. So these are the 3 reasons why some persons would like to form a private limited company. One, the liability is limited. 2, the businesses within a limited circle; therefore, more control can exercised. And 3, the company matters can be kept to, can be kept private.

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Public Limited Company

- It is a voluntary association of members which is incorporated.
- The minimum number is 7 with no maximum limit.
- It has a separate legal existence apart from its members.
- All its activities are strictly governed by laws, rules and regulations. The Indian Companies Act, 1956.
- Has to register Registrar of Companies.
- It collects its capital by the sale of its shares.
- The shares of a company are freely transferable.
- Liability of a member is limited to the face value of the shares he owns.
- The power of decision making is vested in the Board of Directors.
- It enjoys continuity of existence.



Now we talk of public limited company. Public limited company, it is also a voluntary association of members. The minimum number of the members is 7. Whereas in a private limited company, it was 2. In a public limited company, it is 7 and with no maximum limit. In a private limited company, the maximum limit was 50. In a public limited company, there is no maximum limit.

Like private limited company, it also has a separate legal existence, separate from its members. All the activities of such a company are strictly governed by laws, rules and regulations following the Indian Companies Act 1956. Such a company also has to register with the registrar of companies and here, it collects its capital by the sale of its shares to the public. That is where the private limited company cannot access the public.

A public limited company on the other hand can approach the public giving its prospectus and asking the public, general public to buy its shares and become owners and that is how the capital can be raised for starting a business and for expanding the business. Now shares of a company are freely traded or transferable, unlike in the case of private limited company where the transfer takes place among the members of the company.

Here any person can buy anybody else's, a company's share from another share holder. That means the share of the particular company is freely tradable in the stock market. Liability of the

member is limited to the face value of the shares he or she owns. This is also same as the private limited company.

However, since the actual owners of a public limited company may lie geographically very far from the place where the company is situated, the actual running of the problem or of the company is done by a board of directors and different managers. The Board of Directors are actually there to take long-term strategies and decisions and they are actually implemented by the managers and like private limited company, such a company also enjoys continuity of its existence.

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Limited Liability Partnership (LLP)

- It combines the flexibility of a partnership and the advantages of limited liability of a company.
- Useful for SMEs and for the enterprises in services sector, particularly for activities involving professionals.
- Governed by the **Limited Liability Partnership Act 2008**.
- It is a legal entity separate from its partners.
- The minimum number of partners is 2 and at least 2 individuals as Designated Partners.
- It is incorporated with the **Registrar of Societies**.
- It has a perpetual succession.
- A statement of accounts and solvency shall be filed with the Registrar annually. Accounts of LLPs shall also be audited.
- Central Government has powers to investigate its affairs.
- The compromise, merger and amalgamation to be in accordance with the provisions of the LLP Act 2008.



Now we talk about still another form of ownership, it is Limited Liability Partnership (LLP), Limited Liability Partnership. Now recall that in a partnership type of organisation, the liability of a partner was unlimited. Now this is a new form of ownership which is legally started by the government in 2008 by promulgating Limited Liability Partnership Act or LLP Act 2008. Thus it has a very recent origin.

Now what are the features of such a form of ownership? It combines the flexibility of a partnership and the advantages of a limited liability company. So limited liability, the main advantage of a partnership, main disadvantage of a partnership was that the liability is unlimited but here the liability is limited. This is useful for small and medium enterprises and for the

enterprises in service sector, particularly for activities involving professionals, this is a good form of partnership, this form of business.

It is governed by the Limited Liability Partnership Act 2008. It is a legal entity separate from its partners. Now this is another advantage. There we said that if a partner expires, then its, the partnership firm ceases to exist but in this case, it is not so. It is a legal entity separate from its partners. That means it continues and if any legal cases come, it will be not against the partners but against the business and minimum number of partners is 2 as is the case for partnership type of organisation and at least 2 individuals are designated as designated partners.

Like partnership, it is incorporated. Unlike partnership it is incorporated with the registrar of societies. Now normally co-operatives are registered with the registrar of societies and not partnership but here it is incorporated with the registrar of societies and it has a perpetual succession because it is a separate legal entity, independent of its partners. Therefore, it has a perpetual succession unlike in the case of partnership.

But because it is registered with the registrar of societies, a statement of accounts and solvency shall be filed with the registrar annually. So every year, such a business organisation has to submit a statement of its financial accounts and how well it is doing. Solvency means how well it is doing financially. It has to be submitted, this too has to be submitted to the registrar every year and further accounts of such businesses will also have to be audited by independent auditors.

Further central government has powers to investigate its affairs and compromising between, whenever there are controversial matters concerning suppliers or customers or between the partners, or if this has to merge or amalgamate with some other company or some other business organisation, this has to be done in accordance with the provisions of the Limited Liability Partnership Act 2008. So this is another form of business organisation.

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- A firm, private company, or an unlisted public company is allowed to be converted into LLP.
- Winding up of an LLP may be either voluntary or by a Tribunal to be established under the Companies Act, 1956.



Now a firm, an existing firm or a private company or an unlisted public company, is also allowed to be converted into an LLP, this is an advantage given that any firm, cooperative, any partnership firm or a private company or even a public company which is not listed in trade market, is allowed to be converted into a limited liability partnership type of business and if an LLP has to be wind up, it can be done either voluntarily or by a tribunal which is established or which can be established under the Companies Act 1956. So these are the features of the limited liability partnership type of firm.

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Companies within Section 25 of Companies Act, 1956

- Company established for promoting art, science, religion, social cause, sports, education, research, charity or any other activities with the sole objective to promote such activities.
- Profit, if any, is used to further the same objectives, not for payment of dividends.
- Many privileges and exemptions under Company Law.
- Exemption from requirement of minimum paid-up capital.
- Exemption of stamp duty for registration.
- Provision under Section 25 of Companies Act, 1956
- It is a limited-liability company without the words "limited" or "private limited" appearing in its name.



Now we take up 2 more forms of business organisation, strictly speaking they are not, they are little different really. Say for example this particular one is coming under Companies Act Section

25. So they have some special privileges. That is why I thought I should include it as a separate form of business. It is also a company but it is a company that is established for promoting art, science, religion, social cause, sports, education, research, charity, or any other activities with the sole objective to promote such activities.

So this is the promotion of various things: art, science, religion, social cause, sports, education, research, charity, etc. Profit if any, is used to further the same objectives. If such a company makes some profit, this profit will not be distributed as dividends. It will instead be reused to further the very objectives of promoting anything: art, science, religion, etc. So this is a very important characteristic of this particular type of company and it has got various privileges and exemptions granted under the Company Law Section 25.

For example, it does not require a minimum paid-up capital, it does not have to give stamp duty and provision under Section 25 will be applicable here and such a company need not have the word limited or private limited appearing in its name. I forgot to tell that in a public limited company, the word limited must appear and in a private limited company, there are 2 words, private limited must appear.

So private limited, these 2 words must appear in the name of a private limited company, whereas of the word limited must appear in a public limited company. Whereas a company that is formed under Section 25 may not have either the word limited or the 2 words private limited appearing in its name.

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Franchise

- A franchise is a privilege or right officially granted to offer specific products or services under explicit guidelines at a certain location for a declared period of time.
- It is a long-term cooperative relationship between a **franchisor** and one or more **franchisees** based on an agreement in which the franchisor provides a licensed privilege to a franchisee to do business.
- The franchisor grants a franchisee the right to use a developed concept, including diverse intellectual property rights, namely, know-how, designs, brands, trade marks, patents, and trade secrets, production, service and marketing methods and the entire business operation model, for a fee.



Lastly, we are talking about franchise. A franchise is a privileges or right that is officially granted to someone to offer specific products or services under explicit guidelines at a certain geographical location for a declared period of time. That means someone grants certain rights or privileges to someone else for a specific period of time to operate its products and services that is specified under certain explicit conditions or guidelines in a particular geographical location.

Now the one that gives this offer is known as a franchisor and the one that receives the right or the privilege is called a franchisee. So a franchise is basically a long-term co-operative relationship between a franchisor and one or more franchisees based on an agreement. So basically this is an agreement between a franchisor and a franchisee in which the franchisor provides a licensed privilege to a franchisee to do business.

And as I said earlier in a particular geographical location and for a specific period of time. Now the franchisor grants a franchisee, what sort of rights? The right to use a developed concept including diverse intellectual property rights such as knowhow, designs, brands, trademarks, patents, trade secrets, production methods, service methods, marketing methods and the entire business operation model.

So franchisor gives a license with the help of an agreement to the franchisee many things, its intellectual property rights and various methods of producing, giving service and marketing and

even maintaining sometimes the entire business operation model for a fee. Naturally the franchisee has to pay an annual fee to the franchisor. Now this is on the rise because many multinational companies are setting up franchising or franchises in different parts of India, this has become a worldwide phenomenon.

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- There is no franchise-specific legislation in India.
- A franchise arrangement is thus governed by various statutory enactments.
- A gist of some of the important statutes is summarized below.
 - Indian Contract Act, 1872
 - Intellectual Property Law governed by Trademarks Act, 1999, Copyright Act, 1957 and Designs Act, 2002.
 - the Trade and Merchandise Marks Act, 1958
 - Monopolies and Restrictive Trade Practices Act, 1969
 - Consumer Protection Act, 1986



The decision to register or not register an agreement lies with the parties to the agreement.

We in India do not have any franchise-specific legislation, this should be understood. There is no franchise-specific legislation in India. But a franchise arrangement is governed by various statutory enactments and some of them are written down here. A gist of some of the important statutes that are relevant in the context of franchise formation is this, Indian Contract Act 1872, Intellectual Property Law governed by Trademarks Act 1999, Copyright Act 1957 and Designs Act 2002.

The Trade and Merchandise Marks Act 1958. The MRTP Act, Monopolies and Restrictive Trade Practices Act 1969, Consumer Protection Act 1986 and the Other Pollution Control and Environment Related Acts that are applicable to all industries and businesses in our country are also applicable to franchises. Various countries are now going for legislating rules for franchises but in India, we still do not have that and therefore, one has to go through all this.

However, it is not mandatory that the agreement between a franchisor and a franchisee need to be registered. The decision to register or not register, the agreement, lies with the parties to the

agreement. It is not mandatory that they need to register but if it is registered, then it is easy because later if some controversy arises between the 2 parties, then it can be resolved in a much better fashion, then if it is not registered at all.

So friends today we have discussed various forms of ownership starting with the sole proprietorship to franchises. In between we talked of partnership firms, cooperatives, private limited companies, public companies, public limited companies and PPLs. Now an entrepreneur has to naturally be fully aware of different forms of ownership and their characteristics so as to decide what form of ownership is the most suitable for him. In our next class, we shall talk about, in particular, small-scale businesses and how to start a particular form of company. Thank you very much.