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Commercial

Applications

26/6/2020

Class - IX

Chap - 2 (Ownership Structures)

judge of all matters pertaining to his business, subject only to the general laws of the land and to such special legislation as may affect his particular business."

— Kimball and Kimball

Thus, sole proprietorship is a form of business that is owned, managed and controlled by an individual. It is a "one man show."

2.2. FEATURES OF SOLE PROPRIETORSHIP

The distinguishing characteristics of sole proprietorship are as follows:

- ✓ **1. Single Ownership :** A sole proprietorship is wholly owned by one individual. The individual supplies the total capital from his own wealth or from borrowed funds.
- ✓ **2. One-Man Control :** The proprietor alone takes all the decisions pertaining to the business. He is not required to consult anybody. Ownership and management are vested in the same person. Some persons may be employed to help the owner but ultimate control lies with him.
- ✓ **3. No Separate Legal Entity :** A sole proprietorship has no legal identity separate from that of its owner. The law makes no distinction between the proprietor and his business. The business and the owner exist together. If the owner dies or becomes insolvent the business is dissolved. The proprietor and his business are one and the same.
- ✓ **4. Unlimited Liability :** The proprietor is personally liable for all the debts of the business. In case the assets are insufficient to meet its debts, the personal property of the proprietor can be attached.
- ✓ **5. No Profit Sharing :** The sole proprietor alone is entitled to all the profits and losses of business. He bears the complete risk and there is nobody to share the profits or losses.
- ✓ **6. Small Size :** The scale of operations carried on by a sole proprietorship is generally small. A sole trader can arrange limited funds and managerial ability. Therefore, the area of operations is generally local and limited.

7. No Legal Formalities : No legal formalities are required to start, manage and dissolve a sole trader business. Only a license is necessary in certain types of business.

2.3. MERITS OF SOLE PROPRIETORSHIP

The main advantages of sole proprietorship are as follows.

- ✓ **1. Easy to Start and Dissolve :** A sole proprietorship can be set up easily and quickly. No legal formalities and expenditures are involved in the establishment of a proprietorship. There is no need to associate others or to enter into any agreement. Only a license may be needed in special cases e.g. for opening a wine shop, chemist shop, etc. The proprietor can start business operations as and when he desires. Similarly, a sole proprietorship can be closed down very easily and quickly.
- ✓ **2. Motivation to Work :** The sole proprietor alone is entitled to receive all the profits of business and he alone has to bear all losses. There is a direct relationship between effort and reward. Therefore, there is an incentive to work hard. The proprietor is motivated to make the best possible use of his skills and resources to maximise profits.
- ✓ **3. Quick Decisions :** The sole proprietor is completely free to take decisions and to implement them. He need not consult others or seek their approval. Quick decisions and prompt actions help to improve the efficiency of business operations. The proprietor can take on-the-spot decisions and will, therefore, not let any opportunity slip away.
- ✓ **4. Independent Control :** The sole proprietor is the supreme judge of all matters pertaining to his business. He enjoys complete freedom of action. No legal formalities are to be complied with and nobody can interfere in his work. He exercises control over all functions of business. Authority and responsibility are vested in the same person. Personal supervision helps to improve the efficiency of business.

✓ **5. Secrecy :** No secrets are required to be kept. The proprietor is expected to keep the business confidential. Complete secrecy is maintained. This gives him greater control.

✓ **6. Personal Supervision :** The proprietor maintains personal supervision over the business and employees. This ensures the quality of each and every product. It also helps in maintaining healthy relations with customers.

7. Inexpensive : The sole proprietor is not required to share the profits of the business. He alone manages the business and also enjoys the fruits of his management.

8. Flexibility : The sole proprietor can change the business structure, location, etc. whenever he wishes. He can change or modify the business plan, consulting with the customers and without any restrictions.

9. Social Responsibility : It is desirable for a sole proprietor to provide social services to the community. It provides an opportunity for independent diffusion of resources and helps in the development of the community.

2.4. DE MERITS OF SOLE PROPRIETORSHIP

Sole proprietorship has the following merits:

- ✓ **1. Limited Liability :** The liability of the proprietor is limited to the amount of capital invested. The proprietor may be personally liable for the business but his personal assets are not at risk. This is limited liability. It helps in the growth of the business.
- ✓ **2. Control :** The sole proprietor has complete control over the business. He is not required to consult anybody. This helps in the efficient management of the business.

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Ownership Structures — Sole Proprietorship and Joint Hindu Family Business

LEARNING OBJECTIVES

After studying this chapter, you should be able to understand :

- 2.1. Meaning of Sole Proprietorship
- 2.2. Features of Sole Proprietorship
- 2.3. Merits of Sole Proprietorship
- 2.4. Demerits of Sole Proprietorship
- 2.5. Suitability of Sole Proprietorship
- 2.6. Joint Hindu Family Business.

The first and the oldest form of ownership structure is the sole proprietorship. It is the oldest, commonest and simplest and in some cases the most natural form of ownership.

2.1. MEANING OF SOLE PROPRIETORSHIP

Some popular definitions of sole proprietorship are given below :

✓ "Sole trader business is a type of business unit where one 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

"Sole proprietorship is an informal type of business owned by one person."

— James Limdy

"A sole proprietor is a person who carries on business exclusively by and for himself. The leading feature of this kind of concern is

that the individual assumes full responsibility for all the risks connected with the conduct of the business. He is not only the owner of the capital of the undertaking but is usually the organiser and manager and takes all the profits or responsibility for losses."

— James Stephenson

"Under the sole proprietorship form of ownership, a single individual organises and operates the business in his own name. He is not only responsible for its management but also for its risks."

— J.A. Shubin

"A sole proprietorship has no legal existence apart from the proprietor himself. He is the firm." — Peterson and Plowman

"The proprietorship is that form of business organisation which is owned, managed and controlled by a single individual who receives all profits and risks all his property (except a small amount sometimes exempted by law) in the success or failure of an enterprise."

— Charles Tippetts

"The individual proprietor is the supreme

✓ **5. Secrecy of Affairs :** The sole trader is not required to publish his accounts. He is not expected to share his secrets with others. Complete secrecy of business affairs provides him greater competitive strength.

✓ **6. Personal Touch :** The sole proprietor can maintain personal contacts with his customers and employees. He can cater to the requirements of each and every customer. He can also build healthy relations with his employees.

7. Inexpensive Management : The sole proprietor is the owner, manager and controller of the business. Therefore, the expense of management are minimum. A sole proprietor can also enjoy the benefits of hereditary goodwill.

8. Flexibility of Operations : A sole trader business is usually small in size and simple in structure. It can, therefore, be adjusted easily whenever necessary. The proprietor can easily change or modify his line of business to suit the changing conditions of the market, without consulting anybody. There are no legal restrictions on the sole proprietor.

9. Social Desirability : Sole proprietorship is desirable from the social point of view : (a) It provides self-employment. (b) It is an independent way of life. (c) It makes for diffusion of business ownership. It offers equal opportunity to all to use their talents and resources to their maximum advantage. (d) It helps in the decentralisation of economic development in the country.

2.4. DEMERITS OF SOLE PROPRIETORSHIP

Sole proprietorship suffers from the following disadvantages.

✓ **1. Limited Capital :** The capital resources are limited to the personal savings and borrowings of the proprietor. His own assets may be insufficient and his borrowing capacity is limited. Therefore, there is limited scope for growth of business.

✓ **2. Limited Managerial Skills :** A single person is unlikely to possess the necessary skills

in all aspects of business. He may not be able to manage the business efficiently. There is lack of specialisation in sole proprietorship. The proprietor may feel overburdened and his decision might be unbalanced. He cannot afford to employ experts to manage the business.

✓ **3. Unlimited Liability :** The proprietor is personally liable for all the debts of the firm. If the business assets are insufficient, his personal property can be used to pay creditors. His capacity to take risks is reduced.

✓ **4. Lack of Continuity :** The life of sole proprietorship is uncertain. Illness, insolvency or death of the proprietor may lead to termination of business. The businessman may lack the required qualities or aptitude for business.

✓ **5. Limited Scope for Expansion :** Due to the limitations of capital and management, proprietorship business cannot grow and expand to a large size. Economies of large scale operations cannot be obtained. Its goodwill and bargaining position are also weak.

2.5. SUITABILITY OF SOLE PROPRIETORSHIP

Thus, sole proprietorship has several advantages and disadvantages. According to William R. Basset, "the one-man control is the best in the world if that man is big enough to manage everything." But, one man can rarely manage and control everything. Therefore, sole proprietorship is a suitable form of organisation in the following cases :

- ✓ (a) Where the market is local, e.g., small-scale retailers;
- ✓ (b) Where personal attention to the needs and preferences of customers is essential, e.g., tailoring, beauty parlours, etc.;
- ✓ (c) Where fashions change very frequently, e.g., artistic jewellery;
- ✓ (d) Where small amount of capital is required but personal skills are more important, e.g., health clinic;

8. Ancestral Goodwill : A joint Hindu family business enjoys the benefits of an ancestral goodwill. There is a close kinship among the family members as every member has an equal share. The creditworthiness of the business is high due to the large property of the family and unlimited personal liability of the *karta*.

9. Quick Decisions : The *karta* alone is authorised to take all important decisions of the family business. He need not consult other members of the family. His decision is final and cannot be challenged.

10. Economy : Expenses of management are low as *karta* is the sole manager and controller of business.

11. Flexibility of Operations : Undivided control creates flexibility in business. The family firm is free from legal restrictions.

Demerits : Joint Hindu family business suffers from the following disadvantages :

1. Limited Capital : The capital of joint Hindu family business is limited to the ancestral property. The family property gets divided on the birth of every male member. The business cannot expand and grow due to shortage of capital.

2. Unlimited Liability : The liability of the *karta* is unlimited. His private property is liable to pay the debts of the business.

3. Limited Managerial Ability : The *karta* alone may not be competent to manage the business. There is lack of specialisation and professional management.

4. Hasty Decisions : Decisions taken by the *karta* may sometimes be hasty and unbalanced. This is because he is overburdened with work.

5. Responsibility not Matched with Reward : The *karta* manages the business single-handedly and he alone bears unlimited liability. But his share in the business is equal to that of any other member. He receives no extra reward for the extra work he has to do. There is little incentive for him to work hard.

6. Source of Conflict : Exclusive control by the *karta* often creates lack of trust on the part of other members. Suspicions and conflicts may arise because the *karta* alone knows all the trade secrets. This may lead to a split in the joint family system and disintegration of the family business.

7. Scope for Misuse : Being the senior-most member of the family, the *karta* has complete control on the family business. He may misuse his authority for personal gains.

Distinction between Proprietorship and Joint Hindu Family Business

Point of Distinction	Proprietorship	Joint Hindu Family Business
1. Basis of formation	No agreement	By birth
2. Number of members	One-man show	Two or more. No maximum limit
3. Status of females	No discrimination	Cannot be co-parceners
4. Liability and risk	Unlimited proprietor bears all risks	Limited except for <i>karta</i>
5. Position of minor	Can set up business	Can be co-parcener
6. Management	By the sole proprietor	Only by the <i>karta</i>
7. Division of profit	All profits for proprietor; no division	Equal share
8. Legal existence	Dissolved with death of proprietor	Not dissolved by death etc. of a member
9. Application of law	The Contract Act	Hindu Succession Act
10. Registration	Not required	Not required

- (e) Where quick decision and prompt action are necessary, e.g., stock brokers;
(f) Where risk involved is negligible, e.g., doctors, lawyers, chartered accountants.

2.6. JOINT HINDU FAMILY BUSINESS

The joint Hindu family business refers to a business which is owned and managed by the members of a joint Hindu family. It is also known as Hindu Undivided Family Business. It is governed by the Hindu Succession Act. This form of business is created by the law of succession. The joint Hindu family form of business is one in which the family possesses some inherited property. The share of ancestral property is inherited by a male member from his father, grandfather and great-grandfather. Thus, three successive generations can simultaneously inherit the ancestral property. All the male members having a share in family property are known as *coparceners* and the oldest male member is called the *karta*.

Features : The main characteristics of Joint Hindu Family Business are as follows:

- 1. Membership :** A person becomes a member in the family business by virtue of his birth in the family. No formal agreement is necessary between the family members. The membership is restricted to three successive generations. Only male members can be coparceners. A female relative of a deceased male coparcener will have a share after the death of the coparcener. Minors are also full-fledged members of the family business. There is no limit on the number of members.
- 2. Management :** The management of joint Hindu family business is rested in the *karta*. The *karta* may, however, associate other members to assist him in the management of family business.
- 3. Liability :** The liability of the *karta* is unlimited. The liability of other members is limited to the extent of their share in the property of the family business.

4. Right to Accounts : Coparceners are entitled to inspect the accounts of the business. However, a coparcener who is leaving the family business can demand accounts from the *karta*.

5. Dissolution : Joint Hindu family business is not dissolved on the death of a coparcener. It comes to an end when all the members realise that they are not members of the joint Hindu family.

Merits : Joint Hindu family business enjoys the following advantages:

- 1. Ease of Formation :** A joint Hindu family business can be started easily and quickly. No legal formalities are involved.
- 2. Freedom of Action :** The *karta* has complete control on the family business. The management of business is centralised in the hands of the eldest and most experienced man. No other member of the family can interfere in his management.
- 3. Personal Contact :** A joint Hindu family business can maintain direct and intimate contacts with its employees and customers. It can provide personal attention to the requirements of its customers.
- 4. Utmost Secrecy :** The secrets of business are known to the *karta* only. There is, therefore, no danger of the trade secrets being disclosed to outsiders. Secrets of business are not known even to other members of the family.
- 5. Limited Liability :** The liability of all members except the *karta* is restricted to their share in the family property. Their risk is limited and known.
- 6. Continuity :** The existence of a joint Hindu family business is not threatened by the death or incapacity of any member or the *karta*. It is stable and comes to an end only after the total breakdown of the joint family.
- 7. Incentive to Work :** The *karta* is the head of the family. Therefore, he is inspired to work hard for the welfare of the family.

8. Ancestral Goodwill : Ancestral business enjoys the benefit of goodwill. There is a large share of family members as coparceners. The creditworthiness is high due to the large share of family members. The unlimited personal liability of the members cannot be challenged.

9. Quick Decision : The *karta* is authorised to take quick decisions in the family business. The members of the family cannot be challenged.

10. Economy : The expenses are low as *karta* is the controller of business.

11. Flexibility : The control creates a family firm is flexible.

Demerits : Joint Hindu family business suffers from the following demerits:

- 1. Limited Liability :** The liability of the family members is limited to their share in the family property. The family business is not able to expand and grow.

Point to Remember

- | Point to Remember |
|--------------------------------|
| 1. Basis of formation |
| 2. Number of members |
| 3. Status of members |
| 4. Liability of members |
| 5. Position of <i>karta</i> |
| 6. Management of business |
| 7. Division of property |
| 8. Leases and mortgages |
| 9. Appointment of <i>karta</i> |
| 10. Removal of <i>karta</i> |

Q.8. Classify the Commercial Organisation on the basis of ownership structure.

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Class - IX

Chap. 2 (Ownership Structures)

Questions:

- Q.1. Define the term Sole-proprietorship form of business.
- Q.2. Discuss the features of Sole Proprietorship form of business.
- Q.3. Discuss the advantages of Sole-proprietorship form of business.
- Q.4. Discuss the demerits of Sole proprietorship form of business.
- Q.5. What is Joint Hindu Family Business?
- Q.6. Discuss the merits and demerits of Joint Hindu Family Business.
- Q.7. Discuss the features of Joint Hindu Family Business.