

Types of Business Structures in India

You have always had a great business plan and, today, you also have the necessary resources to fulfil your dream of setting it up. But, knowingly or unknowingly, there will always be minor or major hurdles in your way. We, at eSupport, have specialised knowledge in assisting you to overcome these obstacles and to ensure a smooth and successful journey for you. If you are unsure about your legal obligations or require research into your entity-type options, let us try to answer your queries and provide you with the information you need right here.

The following are the different business structures in India:

- A. Sole Proprietorship
- B. Partnership Firm
- C. Private Limited Company
- D. Public Limited Company
- E. Limited Liability Partnership

A. Sole Proprietorship Firm:

This is the oldest and most common form of business. It is a one-man organisation where a single individual owns, manages and controls the whole business. The liability of the owner is unlimited. A Sole Proprietorship business is suitable where the market is limited, localized and where customers give importance to personal attention. This form of organisation is suitable where the nature of business is simple and requires quick decisions. This type of organisation is suitable where the capital required is limited and the risk- involvement is not great. It is also considered suitable for the production of goods which involve manual skill e.g. handicrafts, filigree works, jewellery-making, tailoring, haircutting, etc.

The key features are:

- Ownership by a one single individual who has a legal title to the assets and properties of the business.
- The entire profit goes to the sole proprietor. Similarly, he also bears the entire risk or losses of the firm.
- The owner of the business is the sole manager of the business.
- The entire capital of the business is provided by the owner. He may raise more funds from outside through borrowings
- The proprietor and the business enterprise are one and the same in the eyes of the law.
- The liability of proprietor is unlimited.
- There are less legal formalities.

B. Partnership Firm:

A partnership is defined as a relation between two or more persons who have agreed to share the profits of a business carried on by them or any of them acting for all. The owners of a partnership business are individually known as partners and collectively as a firm. In a partnership firm, persons from different walks of life, with ability, managerial talent and skill, combine to form a business. This increases the administrative strength of the organisation, the financial resources, the skill and expertise, while reducing risk. Such firms are most suitable for comparatively small businesses such as retail and wholesale trade, professional services, medium-sized mercantile houses and small manufacturing units. Generally, it is seen that many organisations are initially started as partnership firms and, later, when it is economically viable and financially attractive for the investors, it is converted into a company.

The key features of a Partnership Firm are:

- A minimum of two persons are required to start a partnership business. The maximum number of partners is 10, in the case of a banking business and 20 in any other case.
- The relation between the partners of a partnership firm is created by contract which may be verbal, written or implied and it is known as the “Partnership Deed”.
- The partners can share profits in any ratio as agreed.
- The partners have unlimited liability.
- The business in a partnership firm may be carried on by all the partners or any of them acting for all. There is a Principal – Agent relationship between all the partners. There should be mutual trust and faith.
- The law does not recognise the firm as a separate entity distinct from the partners
- The registration of a partnership is not compulsory.

C. Private Limited Company:

A private company is a company which has the following ingredients:

- The Shareholders’ right to transfer shares is restricted.
- The number of shareholders is limited to fifty.
- An invitation to the public to subscribe to any shares or debentures is prohibited.

D. Public Limited Company:

A Public Limited Company is a company limited by shares in which there is no restriction on the maximum number of shareholders, transfer of shares and acceptance of public deposits. The liability of each shareholder is limited to the extent of the unpaid amount of the face value of the shares and the premium thereon, in respect of the shares held by him. However, the liability of a Director / Manager of such a company can, at times, be unlimited. The minimum number of shareholders is 7.

E. Limited Liability Partnership:

The government has passed the LLP Act, 2008 in January, 2009. This Act proposes LLP as a new corporate form of business to provide an alternative to the traditional partnership business, with unlimited personal liability on the one hand, and the statute-based governance structure of the limited liability company, on the other, so that businesses can organise themselves and operate in a flexible, innovative and efficient manner.

III. What are the different characteristics of various types of organisations?

A. HUF (Hindu Undivided Family):

- There is no membership other than the members of a Hindu family.
- All coparceners have an equal share in the profit of the business.
- The management of the business is in the hands of the seniormost family member who is known as the Karta.
- The liability of each member of HUF is limited to the extent of his/her share in the business, but the liability of the Karta is unlimited.
- The individual share of each coparcener. This is because every birth of a male child in the family adds to the number of coparceners and every death of a coparcener reduces the number.
- A Joint Hindu family business continues to exist on the death of any coparcener. Even on the death of the Karta, it continues to exist as the next seniormost family member becomes the Karta. However, a joint Hindu family business can be dissolved at any time, either through mutual agreement between members or by division of its assets.

B. Co-operative:

- Individuals having a common interest can come together to form a co-operative society
- The minimum membership required to form a co-operative society is 10 and the maximum number is unlimited
- The registration of a society under the Co-operative Societies Act is mandatory. Once it is registered, it becomes a body corporate and enjoys certain privileges just like a joint stock company
- The primary objective of any co-operative organisation is to render services to its members, in particular, and to society in general
- Every member has a right to take part in the management of the society. Each member has one vote. Generally the members elect a committee known as the Executive Committee to look after the day to day administration and the said committee is responsible to the general body of members
- A co-operative organisation starts with a fund contributed by its members in the form of units called shares. It can also easily raise loans and secure grants from the government.
- The return on capital subscribed by the members is in the form of a fixed rate of dividend after necessary deductions from the profits.

C. Public Limited Company & Private Limited Company:

- The company is different and distinct from its members in law. It has its own name and its own seal, its assets and liabilities are separate and distinct from those of its members. It is capable of owning a property, incurring debts, and borrowing money, having a bank account, employing people, entering into contracts and suing and being sued separately.
- The liability of the members of the company is limited to their contribution to the assets of the company up to the face value of shares held by them.
- A company does not die or cease to exist, unless it is specifically wound up or the task for which it was formed has been completed. Membership of a company may keep on changing from time to time, but that does not affect the life of the company. Death or insolvency of a member does not affect the existence of the company.
- Shares in a company are freely transferable, subject to certain conditions, such that no share-holder is permanently or necessarily wedded to a company. When a member transfers his shares to another person, the transferee steps into the shoes of the transferor and acquires all the rights of the transferor in respect of those shares.
- A company is an artificial person and does not have a physical presence. Therefore, it acts through its Board of Directors to carry out its activities and enter into various agreements. Such contracts must be under the seal of the company. The common seal is the official signature of the company. The name of the company must be engraved on the

common seal. Any document not bearing the seal of the company may not be accepted as authentic and may not have any legal force.

- A company is administered and managed by its managerial personnel i.e. the Board of Directors. The shareholders are simply the holders of the shares in the company and need not necessarily be the managers of the company.

D. Limited Liability Partnership (LLP):

- It is very easy to form an LLP, as the process is very simple compared to that required by companies and it does not involve much formality
- Just like a company, an LLP is also a body corporate, which means it has its own existence, compared to a partnership. An LLP and its partners are distinct entities in the eyes of the law. An LLP will be known by its own name and not by the name of its partners
- LLPs exist as separate legal entities from the personal life of the partner. Both an LLP and the person who owns it are separate entities and both function separately. Liability for repayment of debts and lawsuits incurred by the LLP lies on it and not the owner. Any business with potential for lawsuits should consider the incorporation an LLP; it will offer an added layer of protection
- An incorporated LLP has perpetual succession. Notwithstanding any changes in the partners of the LLP, the LLP will be the same entity with the same privileges, immunities, estates and possessions. The LLP shall continue to exist till it is wound up in accordance with the provisions of the relevant law
- The LLP Act, 2008, gives an LLP the utmost freedom to manage its own affairs. The partners can decide the way they want to run and manage the LLP, in the form of an LLP Agreement. The LLP Act does not regulate the LLP to a large extent; instead it allows the partners the liberty to manage it as they wish.
- It is easy to become a partner or leave the LLP and also to transfer the ownership in accordance with the terms of the LLP agreement
- Another major benefit of incorporation is the taxation of an LLP. LLPs are taxed at a lower rate compared to a company. Moreover, LLPs are not subject to Dividend Distribution Tax compared to a company, so there will not be any tax while profits are distributed among the partners.

IV. Which form of business is suitable and when?

A. Sole Proprietorship:

It is aptly said that "one-man control is the best in the world, if that man is big enough to manage everything." Although sole proprietorship business suffers from certain limitations, it has its own merits. Besides its limitations, it is suitable because it involves low capital investment, personalised services, quick decisions and flexible operations, besides being equipped to serve local needs as well as those of big businesses.

B. HUF (Hindu Undivided Family) - The success of the Joint Hindu Family business is mostly dependent upon the efficiency of the karta and the mutual understanding between the co-partners. Nevertheless, this type of business is losing its ground with the gradual decline in the Joint Hindu family system.

C. Partnership Firm:

A partnership firm is suitable in the case of a business where the initial capital requirement is medium i.e. it is neither too large nor too small. In a partnership firm, partners with different abilities, managerial talents, skills and expertise combine with each partner's contribution based on his area of specialisation and experience.

D. Private and Public Limited Company:

A joint stock company is suitable where the volume of business is quite large, the area of operation is widespread, the risk involved is great and there is a need for huge financial resources and manpower. It is also preferred when there is a

need for professional management and flexibility of operations. In certain businesses, such as banking and insurance, business can only be undertaken by joint stock companies.

E. Co-operative Society:

When the purpose of business is to provide service rather than to earn profit and to promote a common economic interest, the co-operative society is the only alternative. Co-operatives are also preferred as it is easier to raise capital through assistance from financial institutions and the government. Generally, a co-operative society is suitable for small and medium-sized operations. However, the large-sized 'IFFCO' [Indian Farmers and Fertilizers Cooperative] and the Kaira Co-operative Processing Milk under the brand name 'AMUL' are the illustrious exceptions.

F. Limited Liability Partnership (LLP):

LLPs offer clear advantages over Partnership Firms and Companies for small and medium-sized businesses. A registered "Limited Company" in India (private or public) has a lot of complicated formalities, including mandatory director board meetings, auditing etc. The additional overheads in managing a Private Limited Company make LLPs attractive for small firms.

V. What are the principal laws governing various types of organisations?

A. Partnership - Indian Partnership Act, 1932

B. HUF (Hindu Undivided Family) - Hindu Law

C. Co-operative - Co-operative Societies Act, 1912 and State Co-operative Societies Act.

D. Private Limited Company - The Companies Act, 1956

E. Public Limited Company - The Companies Act, 1956

F. Public Sector Unit (PSU) - Special Parliamentary Act

G. Unlimited Company - The Companies Act, 1956

H. Limited Liability Partnership - Limited Liability Partnership Act 2008 and Rules 2009

VI. How should one choose the appropriate form of business?

The selection of a suitable form of business organisation on the basis of ownership and management is one of the most important tasks of the entrepreneur. Once the form of organisation is chosen, it is very difficult to switch over to another form, because it needs the winding-up of the existing organisation which is a waste of time, effort and money. Therefore, the form of an organisation must be chosen after careful thought and consideration. There are a number of factors to be considered while selecting an appropriate form of business organisation. Let us look at those factors which are inter-related and inter-dependent as well:

- ✓ Nature of business
- ✓ Volume of business
- ✓ Area of operation
- ✓ Finance
- ✓ Ownership and control
- ✓ Liability
- ✓ Independence