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Subject : SBILL

Attempt : June 25 Onwards

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Date

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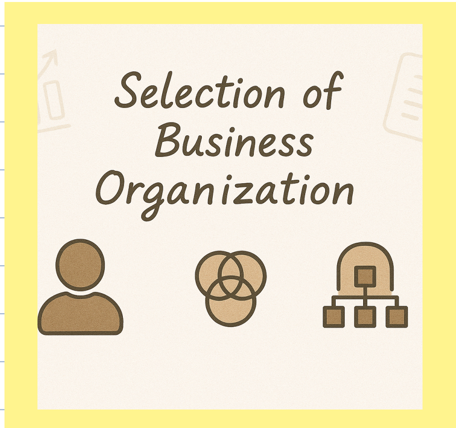
Target : Clear CS Executive in one shot.
With 80 marks in SBILL.



Selection of Business Organization refers to choosing the form of business structure.

The Choice depends upon several factors namely 16.
Objective is to select best structure for running and growing a business.

Forms of Business Structure

1. Sole Proprietorship
2. Partnership
3. Limited Liability Partnership (LLP)
4. Company
5. HUF
6. Co-operative Society
7. Association of Person (AOP)
8. Body of Individual (BOI)
9. Trust

Factors to Consider

1. Nature of Business Activity
2. Scale of operation
3. Capital Requirement
4. Managerial Ability
5. Degree of Control & Management
6. Degree of Risk & liability
7. Stability of Business
8. Flexibility of Administration
9. Division of Profit
10. Cost, Procedure & Govt. Regulation
11. Tax Implication
12. Geographical Mobility
13. Transferability of Ownership
14. Managerial Needs
15. Secrecy
16. Independence

Main Types of Business Organization

1. Sole Proprietorship

- Business owned & operated by single individual.
- Simplest form of business with minimal legal formalities.

Merits
- Easy to establish
- Sole Beneficiary of profit

Demerits
- Unlimited Liability
- Perpetual Succession not possible

2. Partnership

- Business jointly owned and operated by two or more people sharing profit, losses and responsibility
- All the partners contribute something like Money, Skills, or work.

Merits
- Easy to establish
- Perpetual Succession possible, if deed permits

Demerits
- Unlimited liability
- Possibility of Conflicts

3. Limited Liability Partnership (LLP)

- Advance version of Partnership
- Combines benefit of limited liability with the flexibility of partnership.
- A separate legal entity registered under LLP Act, 2008.

Merits
- Limited Liability
- Lower Registration Cost
- No compulsory Audit

Demerits
- Penalty for Non Compliance
- Can't raise Equity investment

4. Company

- A business entity formed by group of individuals to engage in commercial activities.
- Larger form of business structure
- Legal entity created under Companies Act, 2013
- Includes various form :
  1. Private company
  2. Public company
  3. One person Company (OPC)

Merits
- Limited liability
- Perpetual succession

Demerits
- High Maintainence cost
- Highly regulated

5. HUF
6. Co-operative society
7. AOP
8. BOI
9. Trust

→ Exam Book

Factors To Consider

1) Nature of Business Operation

- Refers to type of business or service a business provides such as Trading, Manufacturing or service offering.

- Small Trading & services (Retail Shop, Medicine) - Sole proprietorship is predominant. OPC is also good alternative

- Slightly bigger scale (Real Estate) - Partnership suits business where sole proprietorship is preferable, but with bigger scale. LLP also suits the business, where entrepreneur needs flexibility of partnership with limited liability.

- Large scale - Companies are ideal for activities like chain store, multiple store, super bazar, etc.

2) Scale of Operation

- Size and Extent of business activities, considering factors like No. of employees, production volume, etc.

Small Scale : Sole proprietorship or OPC is suitable.

Modest Scale : Partnership / LLP is preferrable.

Large Scale : Company form of business organisation is suitable.

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3) Capital Requirement

- Amount of Money required to start, run or grow its operations.

Heavy Investment : If enterprise requiring heavy investment (eg: Iron, Steel plant) should be organised as companies.

: They can be set up as public companies and in some cases as listed company to raise funds from public and be listed on stock exchanges.

Small Investment: If an business call for small investment, can be organised as sole proprietorship or partnership.

- In sole proprietorship owner may raise additional capital by borrowing, by purchasing on credit and by investing additional amounts. Banks and suppliers look closely at proprietor's individual financial resources before sanctioning any loan or advances.

Ease of fundraising: Partnership can raise fund with greater ease in comparison with sole proprietorship as resources of all partners get combined.

Attracting capital: Companies are usually best able to attract capital due to transparent operation, public domain presence and easily transferable ownership.

4) Managerial Ability
Refers to skill and experience mandated to run the business and their ability to plan, organise, lead and make decisions.

Sole proprietorship: Sole proprietor must have all the requisite expertise, because one may not allow professional management.

Partnership / company: Work is divided among partners, allowing specialisation in specific areas.

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5) Degree of Control and Management
Degree of control a business owner want to exercise over the business.

Sole proprietorship / OPC: Entrepreneurs has complete control, ownership and management.

Partnership / LLP: Control and management is jointly shared by partners and their rights and obligation would be documented through Partnership Deed. All partners have equal voice in management.

Company: There is divergence (bifurcation) between ownership and management, management and control of company business is entrusted (handed over) to board of directors.

Thus, an individual wishing to have complete or direct control prefers a sole proprietorship / OPC over partnership / company. If he is prepared to share it with others, he will choose partnership. But if activities are large, professional managers are required to handle the day-to-day affairs, he will prefer company.

6) Degree of Risk / Liability
Amount of financial and personal responsibility a business owner has if things go wrong.

Sole proprietorship: Owner is personally liable for all business debt to the extent of personal property. (unlimited liability)

Partnership: Partners are personally and jointly liable for debts of partnership firm. (unlimited liability)

OPC / LLP / Company: Liability of owners / members is limited.

7) Stability of Business
Refers to how long and securely a business can continue to operate. (Perpetual succession)

Companies / LLP / OPC - Most suitable due to perpetual succession and separate legal entity. Members may come and go, but business continues.

Sole proprietorship - least stable as it depends upon individual.

8) Flexibility of Administration : Refers to how easily the management and internal operation of a business can adopt to changes.

Sole proprietorship / Partnership : Most flexible, allowing changes in administration with with minimal inconvenience and loss.

Companies : Rigid structure, less flexible in administration.

9) Division of Profit : Refers to how the money earned by business is shared among its owners / Partner / Member

Sole proprietorship : Owner keep all profit but with unlimited personal liability.

Partnership : Profits are shared among partners.

Company : Profits are distributed as dividend based on shareholding with limited liability for shareholders.

10) Cost, Procedure and Government Regulation - Refers to cost of Registration of business, the procedure to legally set up the business and government regulations

Sole proprietorship : Easiest & cheapest form to start.

Partnership : Simple and inexpensive to set up with minimal regulation.

Company : Most complicated and regulated, with high incorporation cost and cumbersome (hard) winding up process.

11) Tax Implication : Refers to how different business structures affect the amount of taxes a business must pay.

Sole proprietorship / HUF : Taxed based on extent of profit, according to the slab

Partnership / LLP / company : Taxed at flat rate, irrespective of amount of profit.

12) Geographical Mobility : Ability of business to operate in different locations.

Local Market Focus : Sole proprietorship / Partnership is suitable for local business.

Wider Market Reach : A company or LLP is preferred for businesses aiming to operate across India or internationally.

13) Transferability of Ownership : Refers to how easily a business owner can sell or transfer their ownership stake.

Sole proprietorship : No scope of transferability of ownership.

Partnership / LLP : Ownership can change if a partner retires or dies.

Company / OPC : Shares are freely transferable.

14) Managerial Needs - Refers to requirement for managing various department based on size and scale of business

Small Business : One person can manage the business, especially if it caters to local needs. (Sole proprietorship / OPC is preferable)

Large Business : Require specialists to manage different department, making the company form of organisation is suitable.

15] Secrecy : Refers to the ability to keep operations, financial details and strategies confidential

Sole proprietorship: Maximum Secrecy as only owner has access to information.

Company / LLP : Secrecy decreases since details can be accessed through the MCA website. Additionally, companies must also disclose information as per the Companies Act and SEBI Regulations.

16] Independence : Refers to freedom a business owner has in making decisions and controlling the operation.

Sole Proprietorship / Partnership : Minimal government interference and complete control over decision.

Company : Government regulates and oversee the operation and limit operations, as strict adherence to rules is required.

Why Start-up prefers Company form of Business Structure?

Ease Of Funding : Companies can raise outside financing more easily, attracting investors because of transparent operations & public domain presence.

Limited Liability : Shareholder's liabities are limited to their investment, providing financial security, in case anything goes wrong.

Employee Stock Option Plan (ESOP) : Companies can offer ESOPs, helping to attract and retain top talent.

XXX

Mr. X is planning to start a mobile based and web based business. In selection of suitable form of a business organization, 'degree of control and management' plays a significant role. Explain how this factor affects the choice of form of organization.

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 organization.

In sole proprietorship and OPC: ownership, management, and control are completely fused, and therefore, an entrepreneur has complete control over his business.

In partnership: management and control of business is jointly shared by the partners and their specific rights, duties and responsibilities would be documented through incorporating various clauses in this regard in the partnership deed. They have equal voice in the management of partnership business except where they agree to divide among themselves the business responsibilities in a different manner. Even then, they are legally accountable to each other.

In a company: However, there is divergence between ownership and management, the management and control of the company business is entrusted to the Board, who are generally the elected representatives of shareholders.

Thus, a person wishing to have complete and direct control of business prefers proprietary organization rather than partnership or company. If he is prepared to share it with others, he will choose partnership. But, if the activities are large, professional managers are required to handle the day-to-day affairs and there is need for corporate structure and management, he will prefer the company form of organization.

Requirement of capital affects the choice of business organization. Comment? [June 20019]

Definition: Refers to the amount of money a business needs to start, run, or grow its operations.

Heavy Investment: Enterprises requiring heavy investment (e.g., iron and steel plants, large-scale infrastructure projects) should be organized as companies.

They can be set up as public companies and, in some cases, as listed companies to raise funds from the public and be listed on stock exchanges.

Small Investment: Enterprises requiring small investment (e.g., retail businesses, personal service enterprises) can be best organized as sole proprietorships or partnerships.

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.

Ease of Fundraising: Partnerships can often raise funds with greater ease, as the resources and credit of all partners are combined.

Attracting Capital: Companies are usually best able to attract capital due to limited liability for investors, transparent operations, public domain presence, and easily transferable ownership.