

Class: FY BSc

Subject : Business Finance 1

Chapter: Unit 1 Chapter 2

Chapter Name: Types of Business entities

Today's Agenda

1. Business Entities
 1. Characteristics of Business
 2. Types
2. Sole Proprietorship
3. Partnership
4. Limited Company
 1. Public Limited company
 2. Private Limited company
 3. Advantages
 4. Disadvantages
5. Limited Liability partnership
6. Comparison

1 Business entities



Business entity simply refers to the form of incorporation for a business.

- Business entities are essential for starting, managing, and growing your business.
- When a business incorporates, the law recognizes the business as a distinct legal entity which can enter contracts and acquire property among other rights and privileges.
- There are, of course, some exceptions like sole proprietorships and general partnerships, which do not require incorporation. They also do not have the same rights and privileges as incorporated legal entities.
- The legal structure of the firm is likely to have a significant impact on its conduct, and subsequent performance, within the marketplace.

1.1 Characteristics of businesses

Some of the important characteristics of business are detailed below:

- Legal entity and type of ownership
- Profit earning motive
- Risk
- Internal Structure

1.2 Types of Business Entities

Some commonly seen types of business entities are:

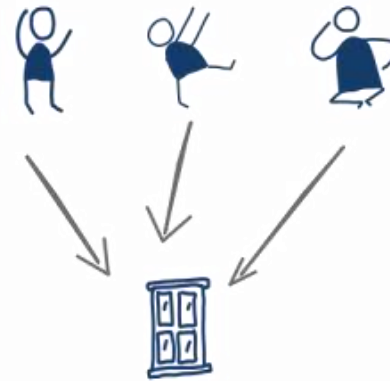
- i. Sole Proprietorship / Trader
- ii. Partnership Firm
- iii. Limited Company
- iv. Limited Liability Partnership



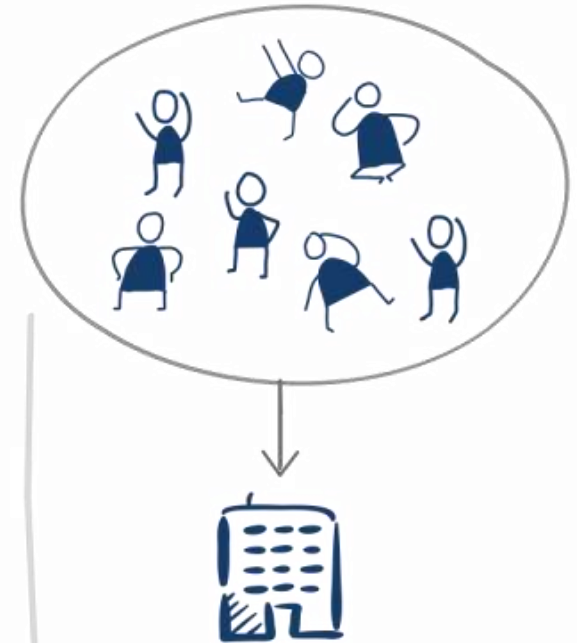
Sole Proprietorship



Partnership



Limited Liability Company



Corporation

2 Sole proprietorship

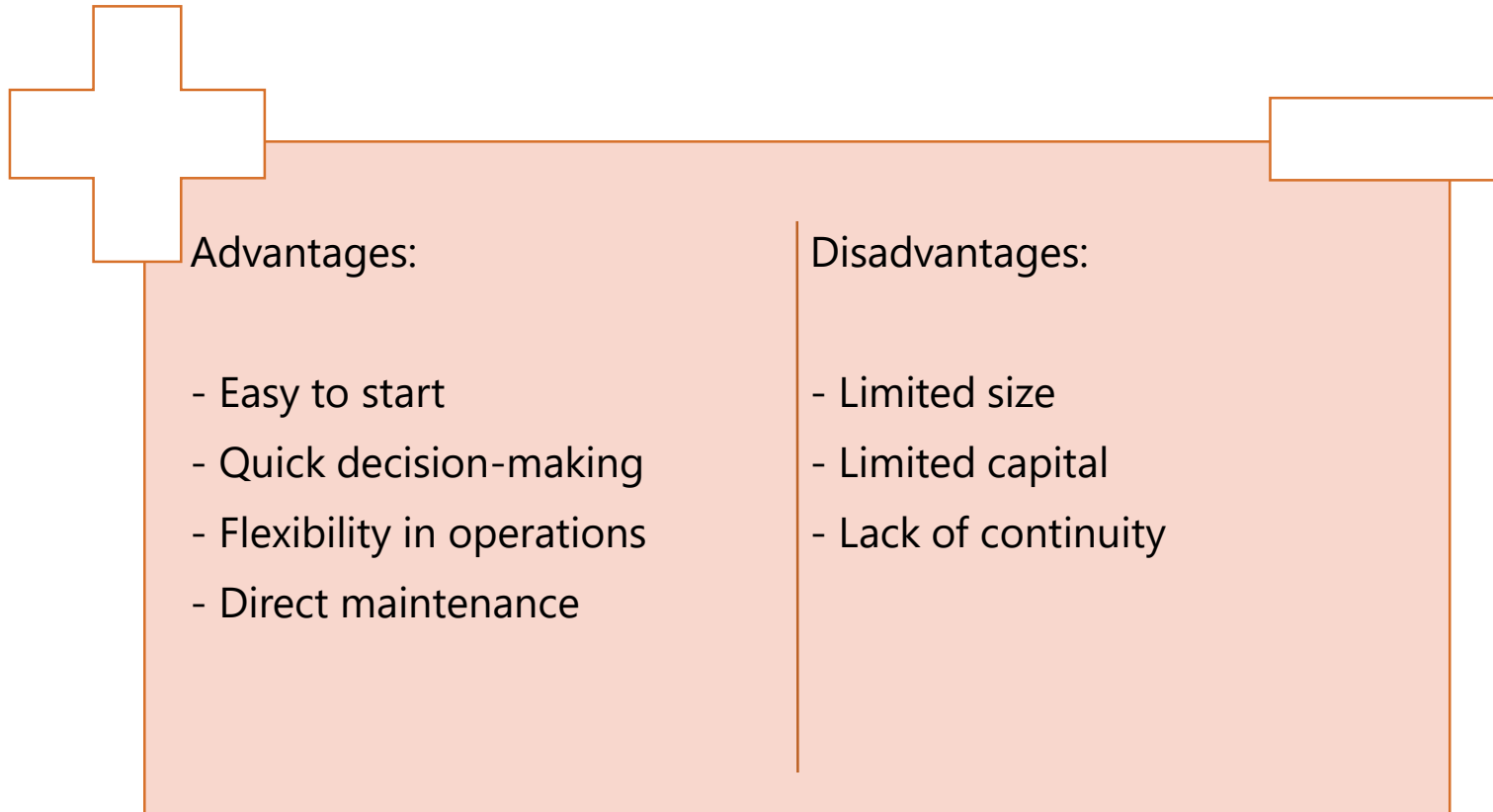


A **sole proprietorship**—also referred to as a sole trader or a proprietorship—is an unincorporated business that has just one owner who pays personal income tax on profits earned from the business.

A Sole Proprietorship has the following qualities:

- i. Business is owned by 1 person
 - ii. Flexibility to further invest or withdraw money from business
 - iii. Unlimited Liability
 - iv. No legal documentation required to register as a Sole Trader but need to file timely tax filings
- Notwithstanding this risk, sole proprietorships are quite common, because individuals want to avoid the cost and hassle of setting up and managing a separate legal entity

2 Sole proprietorship



2 Sole proprietorship

A Refreshing Start: Coca Cola Owes its Origin to a Sole Proprietor!

The product that has given the world its best-known taste was born in Atlanta, Georgia, on May 8, 1886. Dr. John Stith Pemberton, a local pharmacist, produce the syrup for Coca-Cola ®, and carried a jug of the new product down the street to Jacobs' Pharmacy, where it was sampled, pronounced "excellent" and placed on sale for five cents a glass as a soda fountain drink. Dr. Pemberton never realized the potential of the beverage he created. He gradually sold portions of his business to various partners and, just prior to his death in 1888, sold his remaining interest in Coca-Cola to Asa G. Candler. An Atlantan with great business acumen, Mr. Candler proceeded to buy additional business rights and acquire complete control.

On May 1, 1889, Asa Candler published a full-page advertisement in The Journal, proclaiming his wholesale and retail drug business as Atlanta "sole proprietors of Coca-Cola ... Delicious. Refreshing. Exhilarating. Invigorating." Sole ownership, which Mr. Candler did not actually achieve until 1891, needed an investment of \$ 2,300. It was only in 1892 that Mr. Candler formed a company called The Coca-Cola Corporation.
Source: Website of Coca Cola company.

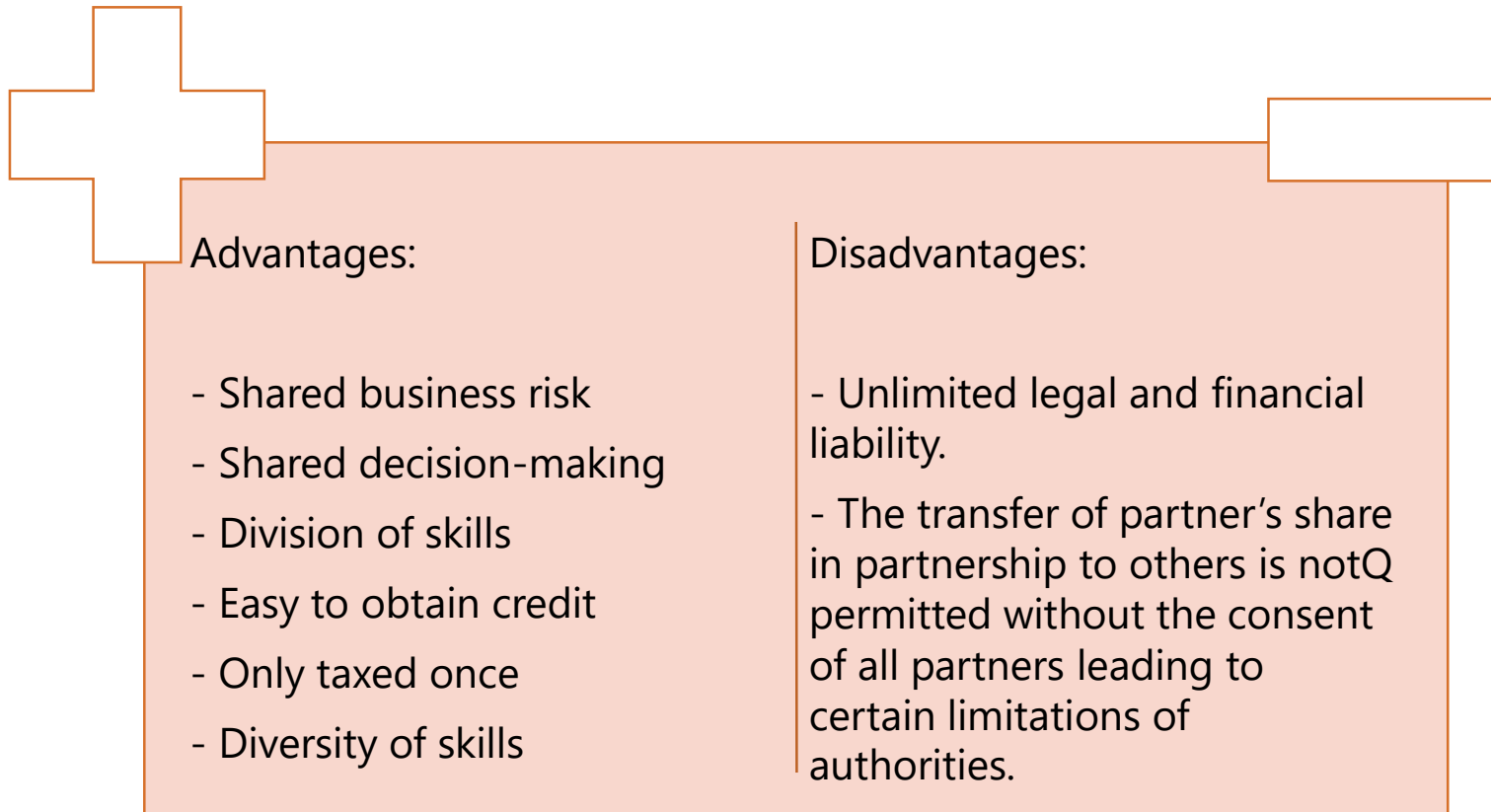
3 Partnership



A partnership is a business which is owned by more than one person and is not a limited company.

- Two or more people come together to form a business.
- There is a division of profits in the agreed ratio.
- The owners have unlimited liability. All the partners are jointly liable for any business debts
- Most partnerships will have a 'partnership agreement' which sets out the rights of individual partners.

3 Partnership



3 Partnership

Types of partners

Type	Capital contribution	Management	Share in profits/ losses	Liability
Active partner	Contributes capital	Participates in management	Shares profits/ losses	Unlimited liability
Sleeping or dormant partner	Contributes capital	Does not participate in management	Shares profits/ losses	Unlimited liability
Secret partner	Contributes capital	Participates in management, but secretly	Shares profits/ losses	Unlimited liability
Nominal partner	Does not contribute capital	Does not participate in management	Generally does not share profits/ losses	Unlimited liability
Partner by estoppel	Does not contribute capital	Does not participate in management	Does not share profits/ losses	Unlimited liability
Partner by holding out	Does not contribute capital	Does not participate in management	Does not share profits/ losses	Unlimited liability

4 Limited Company



A limited company is a business which has a legal identity separate from the owners of the business.

- The owners of the company are called shareholders. Most shares give the right to vote at company meetings. The shareholders will appoint directors who are responsible for the control of the company on behalf of the shareholders.
- Separate Legal Identity
- Separation of Ownership & Management
- Shares need to be purchased to become owner and dividends are paid as return
- The owners' liability is limited to the fully paid value of their shares.
- Legal – MOA (Intention of Starting the Co), AOA (Internal Rules), Cert of Incorporation
- Requirement of maintaining books and get them audited basis certain thresholds

4.1 Public Limited Company



A public limited company is a company whose documentation states that it is a public company and which has an issued share capital of at least £50,000. The name of a public limited company must end with the words 'public limited company' or the abbreviation PLC or plc.

- Public limited companies are owned by its shareholders. These types of companies often issue/offer its shares to common public through an Initial Public Offering (IPO). Shares of these company are often traded on the stock exchange and is governed by tight regulations.
- They are tightly governed with various regulations and strict compliance requirements under Companies Act, 2013

4.2 Private Limited Company



All other limited companies are classed as private limited companies. A private limited company's name must end with the word 'limited' (or the abbreviation LTD or Ltd). A private limited company is not allowed to offer its shares to the public.

- It has to be registered with the registrar of companies (ROC).
- The shares of a private limited company cannot be publicly traded.
- It is a separate legal entity in the court of law.
- Governed under the Companies Act, 2013.

4.3 Advantages of Limited Company

- Limited liability makes it easier to raise capital.
- Limited liability allows large numbers of people to invest small amounts of money with relatively minimal checking of the company's prospects. In turn, this allows investors to diversify their exposure to sectors and to the risk of failure.
- Separation of ownership and management allows share ownership to change without interfering with the operation of the business. It also allows the firm to hire professional managers.

4.4 Disadvantages of Limited Company

- To the creditors:

Once the company's assets have been exhausted, the trade creditors have no way of ensuring payment

- To the company:

Limited liability allows people to invest in shares without taking an active interest in the long-term needs of the company

- To the shareholders:

The managers of a company may have aims which are not in the best interests of the shareholders (this is known as the 'agency problem').

5 Limited Liability Partnership



This is a business vehicle that gives the benefits of limited liability whilst retaining other characteristics of a traditional business partnership.

- Any firm consisting of two or more members (note: not partners) engaged in a profit-making venture, may become a LLP. Unlike limited companies, there are no directors (or company secretary) and, of course, no shareholders.
- The LLP, as with a limited company, is a separate legal entity.
- the liability of its members is limited.
- A LLP is governed by the partnership agreement that may already be in force within an existing partnership.

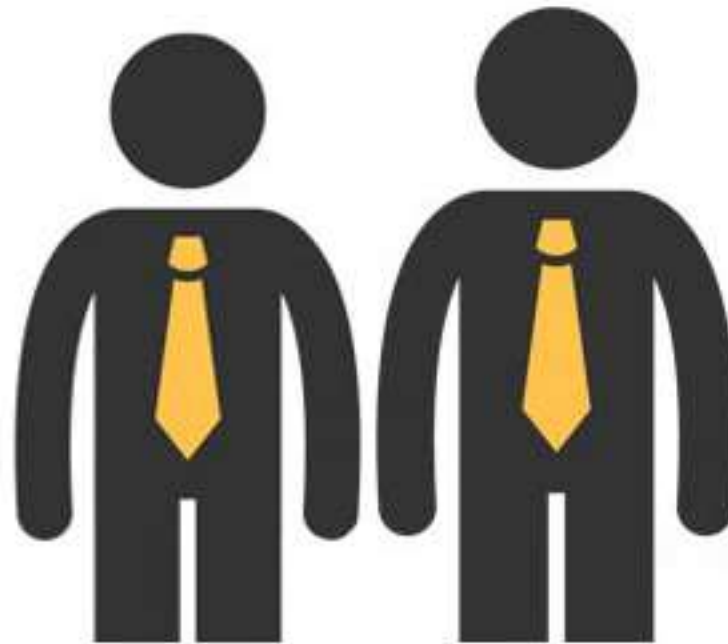
5 Limited Liability Partnership

Benefits of LLP

Min. 2 Partners

Low formation cost

No compulsory
audit



Easy to establish

Limited Liability

Tax benefits

6 Comparison of Business Entities

We've seen how different types of business can be legally created in India. They are broadly compared based on the following factors:

- Source of Funds
- Legal Identity
- Liability of Partners / Members / Shareholders
- Documentation Requirements
- Disclosure Requirements
- Tax Impact