



Class: FY MSc

Subject : Business Finance

Subject Code: PPSAS105

Chapter: Unit 1 Chp 2

Chapter Name: Types of Business Entities

Topics to be covered

1. Business Entities
2. Types of Business Entities
3. Sole Proprietorship
4. Partnership
5. Hindu Undivided Family
6. Limited Companies
7. Limited Companies – Public or Private?
8. Listed Companies
9. Pros and Cons of Limited Companies
10. Limited Liability Partnership
11. Comparison of Business Entities
12. Which Business Entity Structure?

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.

2 Types of Business Entities

Some commonly seen types of business entities are:

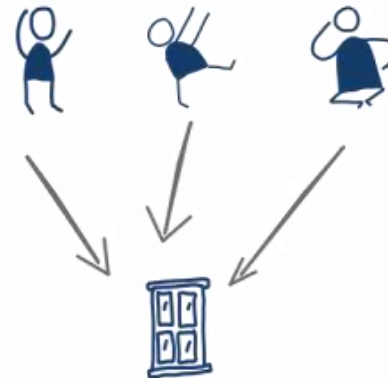
- i. Sole Proprietorship / Trader
- ii. Partnership Firm
- iii. Limited Company
- iv. Limited Liability Partnership



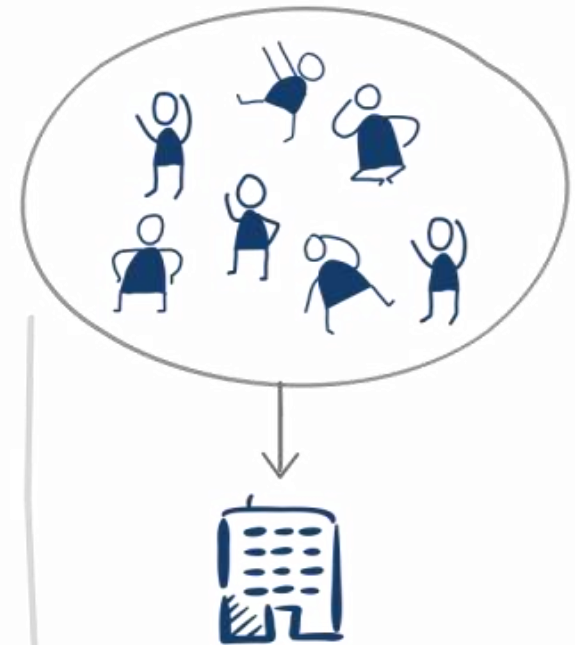
Sole Proprietorship



Partnership



Limited Liability Company



Corporation

3 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



3 Sole Proprietorship



3 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.

4 Partnership

A partnership is a formal arrangement by two or more parties to manage and operate a business and share its profits.

A Partnership has the following qualities:

- i. Business is owned by 2 or more persons
- ii. Active, Sleeping and Investing Partners
- iii. Unlimited Liability
- iv. Partnership Deed between partners to define the overall business arrangement- rights and duties of partners, term, PSR
- v. In UK, Taxed in the hands of individual partners vis-à-vis Firm taxed in India



Partnership

- As partners can each specialize in one aspect of the business, larger organizations are often more viable. However, taking on partners does mean a loss of control through shared decision making.
- Although it has been possible to form limited liability partnerships, many partnerships still have unlimited liability. This problem could be very serious. The mistakes of one partner could jeopardise the personal assets of all the other partners.

4 Partnershi p

Advantages

- ❑ Easy to start
- ❑ Easier to get capital
- ❑ Easier to obtain credit
- ❑ Not dependent on one person
- ❑ Only taxed once
- ❑ Diversity of skills

Disadvantages

- ❑ Business risk is shared among all partners
- ❑ Unlimited legal and financial liability is shared
- ❑ If one member makes a mistake all are responsible

4 Partnershi p

Types of Partners

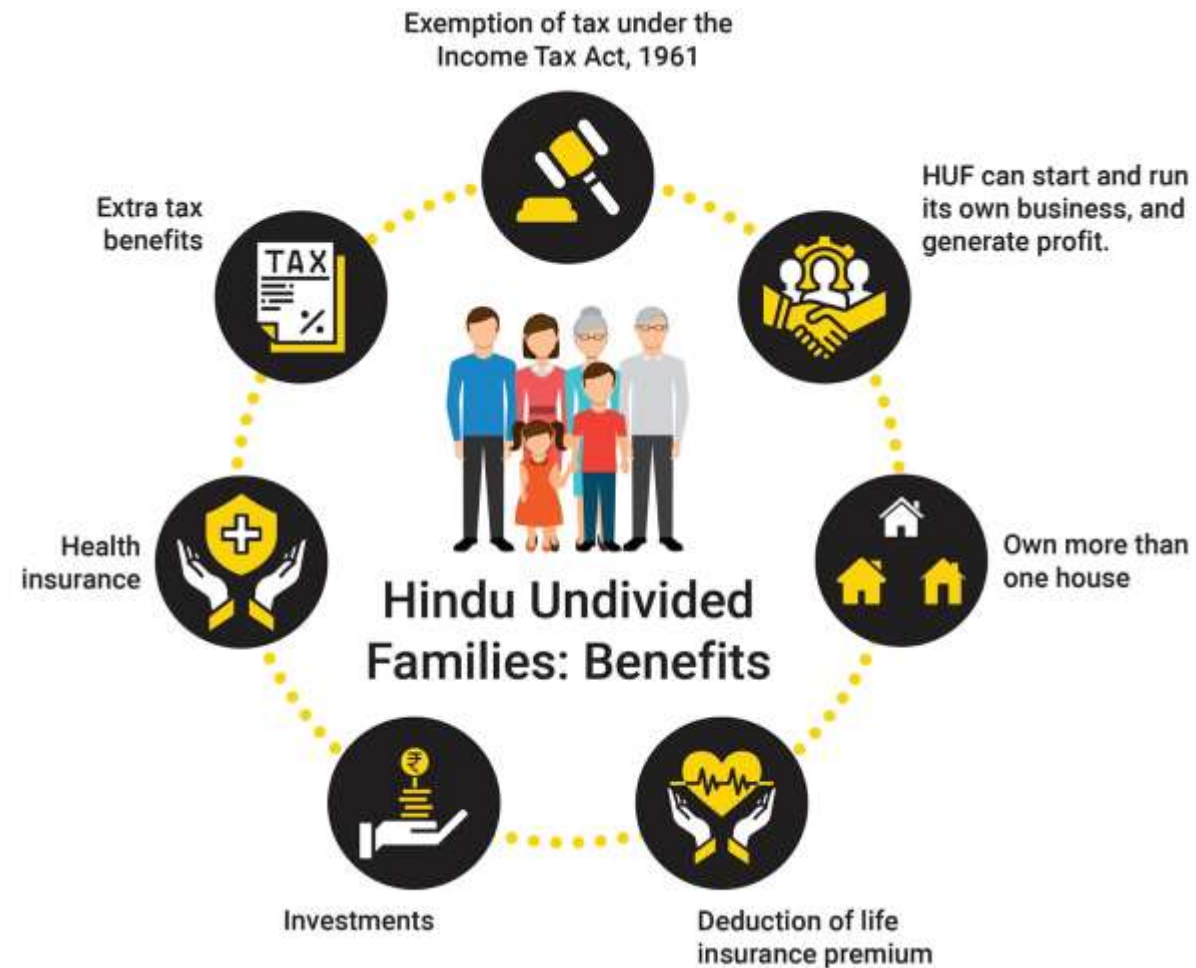
Type	Capital contribution	Management	Share in profits/ losses	Liability
Active partner	Contributes capital	Participates in management	Shares profits/ losses	Unlimited liability
Sleeping or dormant partner	Contributes capital	Does not participate in management	Shares profits/ losses	Unlimited liability
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

5

Hindu Undivided Family

- Joint Hindu family business is a specific form of business organization found only in India. It is one of the oldest forms of business organization in the country.
- It refers to a form of organization wherein the business is owned and carried on by the members of the Hindu Undivided Family (HUF). It is governed by the Hindu Law.
- The business is controlled by the head of the family who is the eldest member and is called karta, who has unlimited liability. All members have equal ownership right over the property of an ancestor and they are known as co-parceners.
- The business does not require any agreement as membership is by birth. It is governed by the Hindu Succession Act, 1956.

5 Hindu Undivided Family

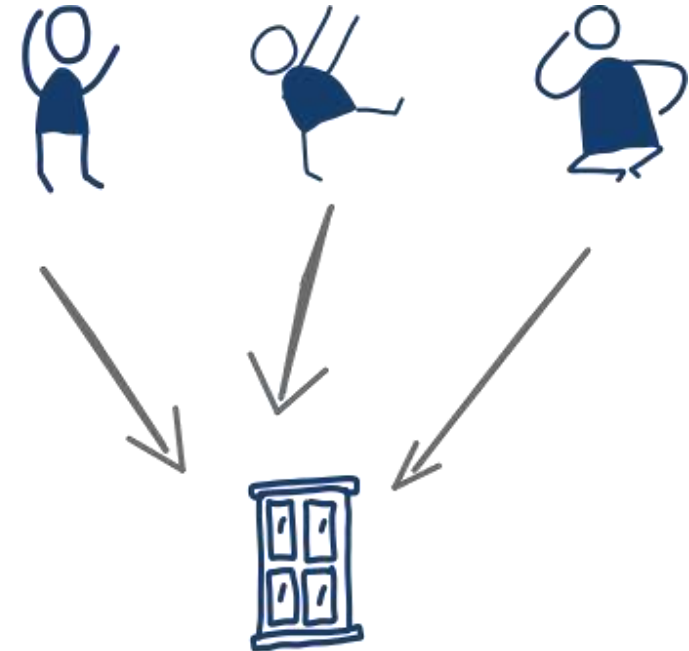


6 Limited Companies

A limited company is a legal entity that is separate and distinct from its owners. Under law, corporations possess many of the same rights and responsibilities as individuals.

Limited Company has the following qualities:

- i. Separate Legal Identity
- ii. Separation of Ownership & Management
- iii. Shares need to be purchased to become owner and dividends are paid as return
- iv. Limited Liability to the Investment Amount
- v. Legal – MOA (Intention of Starting the Co), AOA (Internal Rules), Cert of Incorporation
- vi. Requirement of maintaining books and get them audited basis certain thresholds



Limited Liability Company

7 Limited Companies – Public or Private?

What is the difference between Public and Private Limited Companies?

A Public Limited Company has the following qualities:

- i. Documents mention it to be a Public Ltd Co.
- ii. Issued Share Cap $\geq$ GBP50,000
- iii. Name ends with PLC
- iv. Registered with ROC as a PLC
- v. Produce Audited Accounts every year

A Private Limited Company has the following qualities:

- i. Company is not a Public Ltd Co.
- ii. Name ends with Ltd
- iii. Registered with ROC as a Pvt Ltd Co.
- iv. No offer of shares to Public

8 Listed Companies

A Public Limited Company whose shares are listed on the Stock Exchange and allowed to be freely-traded.

- Most exchanges have specific requirements that companies must meet in order to be listed and continue to stay listed.
- Other types of companies are:
 - Company Limited by Guarantee e.g. Clubs, Associations
 - Company established by Royal Charter e.g. British East India Company
 - Close Company – Controlled by a few

9

Pros and Cons of Limited Companies

Pros

- Shareholders – Limited Liability if taking higher risks and large amount of capital
- Expert Management – Separation of Ownership and Management

Cons

- In case of wind-up, creditors have no surety of payment once assets exhausted
- Conflicts in objectives of Owners and Management
- Shareholders take no active interest in long-term needs of the Company

9 Pros and Cons of Limited Companies

Advantages and Disadvantages of a Public Limited



- Continuity of existence
- Perpetual succession
- Annual return compliance
- Stringent regulation

10 Limited Liability Partnership

Limited Liability Partnerships (LLPs) are a flexible legal and tax entity that allows partners to benefit from economies of scale by working together while also reducing their liability for the actions of other partners.

Limited liability partnership has the following qualities:

- i. Mix of a Company and a Partnership
- ii. 2 or more members
- iii. Separate Legal Entity
- iv. Members have Limited Liability
- v. Partnership Deed between members to define the overall business arrangement- rights and duties of partners, term, PSR
- vi. To be registered with the Companies Board

Limited Liability Partnership



10 Limited Liability Partnership

Benefits of LLP

Min. 2 Partners

Low formation cost

No compulsory audit



Easy to establish

Limited Liability

Tax benefits

11

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

12 Which Business Entity Structure?

After comparison and an in-depth understanding of how companies can be setup, we take into consideration the following factors when we set up a business and decide on it's structure of incorporation.

- Need for Finance; Ease of raising finance
- Possibility of resorting to Debt for Capital
- Ease of set-up / registrations
- Control over business operations
- Roles and Responsibilities
- Disclosure Requirements

Summary

- A business has a legal status and basis when it is founded.
- While Sole Proprietorship and Partnerships have been around for a long time, the evolving need of business's for both capital and resources gave rise to other forms such as limited companies and LLPs.
- All of these have their own advantages and disadvantages and are suitable at certain scales and types of business.
- Those decisions are made on a case-by-case basis and there's no golden yardstick for it.
- Matching the best available legal status of business' to the needs of the business is the appropriate method to incorporate one.

Thank You