

## CHAPTER 2

# Forms of Business Organisation

CBSE Class 11 · Business Studies · Chapter 2

CBSE · Business Studies · Class 11

### WHAT THIS CHAPTER DOES

**A** Identify the five forms of business organisation and their key features.

**B** Master limited vs unlimited liability across every form.

Boards prep that builds confidence, not anxiety.

**TODAY'S MISSION**

# Today's mission

1

Identify the five forms of business organisation and their key features.

2

Master limited vs unlimited liability across every form.

3

Explain the types of partners, the partnership deed, and registration.

4

Distinguish a private company from a public company.

5

Score 9/10 marks on this chapter's slice.

## WHY THIS MATTERS

# Why this chapter matters

1

8-10 marks — one of the two heaviest chapters of the Class 11 year.

2

Liability, control and continuity reappear in every distinguish-type question.

3

Foundation for later chapters on company formation, sources of finance and internal trade.

TOPIC

**A**

# Sole proprietorship

**THEOREM · LOAD-BEARING RESULT**

# What is a Sole Proprietorship?

“ Sole proprietorship is a form of business organisation owned, managed and controlled by a **SINGLE** individual who receives all the profits and bears all the risks.

**STATEMENT**

**Features: single ownership; no separate legal entity (owner and business are one); UNLIMITED liability; the proprietor is the sole risk-bearer and profit-recipient; minimal legal formalities; and**

**WHY THIS MATTERS**

- It is the oldest, simplest and most widespread form — ideal for small businesses (a kirana shop, a tailor, a beauty parlour) where personal attention, quick decisions and secrecy matter and the capital and risk are small.

**WATCH OUT FOR**

**NOTE** The proprietor has **UNLIMITED** liability — personal assets (house, savings) can be used to pay business debts. This is the form's biggest single drawback and a favourite distinguish-type point.

## TOPIC

# Merits and limitations at a glance

## MERITS OF SOLE PROPRIETORSHIP

A sole proprietorship offers **QUICK DECISION-MAKING** because the owner need not consult anyone — full control rests in one pair of hands. It allows complete **CONFIDENTIALITY** of business secrets, since the proprietor alone knows the trade methods and is not required to publish accounts. It gives **DIRECT INCENTIVE**, as the owner keeps **ALL** the profit and so works hard. It provides a strong **SENSE OF ACCOMPLISHMENT** and personal

## LIMITATIONS OF SOLE PROPRIETORSHIP

The form's gravest weakness is **UNLIMITED LIABILITY** — the owner's personal property can be attached to settle business debts, so failure can be ruinous. It commands only **LIMITED CAPITAL** (one person's funds and borrowing capacity), which caps the size of the business. It suffers from **LIMITED MANAGERIAL ABILITY**, since one person cannot be an expert in production, finance and marketing alike. It has **UNCERTAIN CONTINUITY** (perpetual instability)

TOPIC

**B**

# Joint Hindu Family business

## TOPIC

# The Joint Hindu Family (HUF) business

## CONCEPT, KARTA AND MEMBERSHIP

A JOINT HINDU FAMILY business is owned and carried on by the members of a Hindu Undivided Family, governed by Hindu law. Membership is acquired by BIRTH into the family — there is no agreement, unlike a partnership. The business is controlled by the KARTA, the eldest/senior-most member (and, after recent legal developments, a senior female member may also be Karta), who manages the business and takes all decisions.

## FEATURES, MERITS AND LIMITATIONS

The Karta has UNLIMITED liability; all other coparceners have LIMITED liability — restricted to their share in the joint family property. The business enjoys STABILITY (it continues on the death of the Karta, with the next senior member taking over) and centralised, prompt CONTROL under the Karta. Coparceners gain business exposure without bearing unlimited risk. LIMITATIONS include limited capital and resources. the Karta's possible lack of

TOPIC

C

# Partnership — features & types of partners

**THEOREM · LOAD-BEARING RESULT**

# What is a Partnership?

Partnership is the relation between persons who have agreed to share the profits of a business carried on by ALL or ANY of them acting for all (Indian Partnership Act, 1932).

## STATEMENT

Features: **TWO or more persons (min 2, max 50 under the Companies Rules 2014); a CONTRACTUAL agreement (the partnership deed); sharing of PROFITS and losses; MUTUAL AGENCY**

## WHY THIS MATTERS

- Partnership overcomes the sole proprietor's two big limits — capital and managerial ability — by pooling the funds, skills and judgement of several people, while staying simpler than a company.

## WATCH OUT FOR

**NOTE** MUTUAL AGENCY is the defining test of partnership and the most-marked feature: the act of any one partner, within the firm's business, binds all the other partners.

**WORKED EXAMPLE**

# Who's who in a partnership

- 1** ACTIVE (working) partner — contributes capital, takes ACTIVE part in management, shares profit/loss, unlimited liability. Must give public notice on retirement.
- 2** SLEEPING (dormant) partner — contributes capital, shares profit/loss, unlimited liability, but does NOT manage and is unknown to the public.
- 3** SECRET partner — participates in management but membership is hidden from outsiders; still unlimited liability.  
NOMINAL partner — lends only their NAME/reputation, no capital, no profit share, but liable to third parties.
- 4** PARTNER BY ESTOPPEL / HOLDING OUT — by conduct (or by not denying a representation) appears to be a partner and becomes liable to anyone who gives credit on that belief. PARTNER IN PROFITS ONLY — shares profits but not losses.
- 5** MINOR — cannot be a full partner (no valid contract) but may be admitted to the BENEFITS of partnership with all partners' consent; liability limited to their share.

TOPIC

**D**

# Partnership deed, registration & types

## TOPIC

# The partnership deed and registration of a firm

## PARTNERSHIP DEED AND ITS CONTENTS

A PARTNERSHIP DEED is the WRITTEN agreement that contains the terms and conditions governing the partnership. Though a partnership can be oral, a written deed avoids disputes and serves as evidence. Typical CONTENTS include: the name of the firm and of the partners; the nature and place of business; the CAPITAL contributed by each partner; the PROFIT-SHARING RATIO; the rights, duties and obligations of partners:

## REGISTRATION AND CONSEQUENCES OF NON-REGISTRATION

Registration of a partnership firm with the Registrar of Firms is OPTIONAL, not compulsory — an unregistered firm is perfectly legal and may carry on business. However, NON-REGISTRATION brings serious disabilities: (1) a PARTNER cannot file a suit against the firm or other partners to enforce a right; (2) the FIRM cannot sue any THIRD PARTY to enforce a claim; and (3) the firm cannot claim a

## TOPIC

# General, limited and LLP

## GENERAL VS LIMITED PARTNERSHIP; AT-WILL VS PARTICULAR

On the basis of LIABILITY: in a GENERAL partnership all partners have UNLIMITED liability and equal rights of management; in a LIMITED partnership at least one partner has unlimited liability while others limit theirs to their capital (and cannot manage). On the basis of DURATION: a PARTNERSHIP AT WILL continues at the will of the partners and can be dissolved by any partner giving notice; a

## LIMITED LIABILITY PARTNERSHIP (LLP)

A LIMITED LIABILITY PARTNERSHIP, governed by the LLP Act 2008, is a modern hybrid that blends the flexibility of a partnership with the safety of a company. Its defining features are that it is a SEPARATE LEGAL ENTITY distinct from its partners (with perpetual succession, able to own property and sue in its own name) and that every partner has LIMITED liability — a partner is not personally liable for the wrongful acts of other partners. It must have a

TOPIC

**E**

# Cooperative society

## TOPIC

# The cooperative society — service, not profit

### CONCEPT, FEATURES, MERITS AND LIMITATIONS

A COOPERATIVE SOCIETY is a VOLUNTARY association of at least 10 adults who join for their MUTUAL benefit and SERVICE — its motto is 'each for all and all for each' — registered under the Cooperative Societies Act. Key features: voluntary open membership; DEMOCRATIC control on ONE-MEMBER-ONE-VOTE (regardless of capital); a SEPARATE LEGAL entity; LIMITED liability; and surplus shared as a limited dividend on capital plus a

### TYPES OF COOPERATIVE SOCIETIES

Cooperatives are classified by the function they perform. A CONSUMERS' cooperative buys goods in bulk and sells them to members at fair prices, cutting out middlemen. A PRODUCERS' cooperative supplies small-producer members with raw materials, tools and equipment. A MARKETING cooperative pools the output of small producers and sells it collectively for a better price. A FARMERS' (agricultural) cooperative helps members with

TOPIC

**F**

# Joint stock company

**THEOREM · LOAD-BEARING RESULT**

# What is a Joint Stock Company?



A joint stock company is an association of persons, formed under the Companies Act 2013, having a **SEPARATE LEGAL ENTITY**, **PERPETUAL SUCCESSION**, a common seal, and the **LIMITED LIABILITY** of its members.

## STATEMENT

**Defining features: (1) ARTIFICIAL PERSON created by law — it can own property, enter contracts and sue/be sued in its own name; (2) SEPARATE LEGAL ENTITY distinct from its shareholders;**

## WHY THIS MATTERS

- The company form solves the capital and continuity problems of all the smaller forms — it can raise huge sums from the public and outlives its members — which is why all large-scale businesses adopt it.

## WATCH OUT FOR

**NOTE** The two most-marked features are **SEPARATE LEGAL ENTITY** and **PERPETUAL SUCCESSION**; state limited liability precisely as 'limited to the unpaid amount on the shares held'.

TOPIC

# Company merits, limitations & the private/public split

## MERITS AND LIMITATIONS OF A COMPANY

**MERITS:** LIMITED LIABILITY protects members' personal assets; a company can raise LARGE CAPITAL from the public; PERPETUAL SUCCESSION gives a stable, continuous existence; shares of a public company are FREELY TRANSFERABLE, giving liquidity; and PROFESSIONAL MANAGERS ensure efficiency and scale. **LIMITATIONS:** formation is COMPLEX, costly and slow with many legal formalities: heavy GOVERNMENT REGULATION

## PRIVATE COMPANY VS PUBLIC COMPANY (AND OPC)

A PRIVATE company has a minimum of 2 and a maximum of 200 members, at least 2 directors, RESTRICTS the transfer of its shares, CANNOT invite the public to subscribe to shares/debentures, and adds 'Private Limited' to its name. A PUBLIC company has a minimum of 7 members with NO upper limit, at least 3 directors, FREELY transferable shares, CAN invite the public through a prospectus,

TOPIC

**G**

# Choosing the right form

## TOPIC

# Factors in choosing a form of business organisation

## COST, LIABILITY AND CONTINUITY

**COST AND EASE OF FORMATION:** the simpler and cheaper the better for a small business — a sole proprietorship is the easiest and least costly to set up, while a company is the most complex and expensive, so cost favours the smaller forms. **LIABILITY:** where the risk of loss is high, an entrepreneur prefers a form with **LIMITED** liability (company, LLP, cooperative) so that personal assets are protected, rather than the unlimited liability of a proprietorship

## CAPITAL, CONTROL AND NATURE OF BUSINESS

**CAPITAL REQUIREMENT:** a business that needs large funds and room to expand should choose the **COMPANY** form, which can raise capital from the public, while a small-capital venture suits a proprietorship or partnership. **MANAGEMENT ABILITY:** if diverse managerial skills are needed, a partnership or company (which can hire experts) beats a one-person proprietorship. **DEGREE OF CONTROL:** an owner who wants **FULL** direct control will

**TRY IT · SOLVE BEFORE YOU PEEK**

# Quick self-test

Work it out before you flip the answer.

**SOLUTION**

## TOPIC

# Limited vs unlimited liability

## TRAP → TRUTH

× **MISTAKE** In every form of business, the owner can lose only the money they invested.

✓ **CORRECT** This is true ONLY for companies and (largely) LLP and cooperatives. In a SOLE PROPRIETORSHIP and a general PARTNERSHIP, liability is UNLIMITED — if business assets fall short, the owner's/partners' PERSONAL property (house, car, savings) can be attached to pay business debts. In a company the shareholder's liability is LIMITED to the unpaid amount on their shares; personal assets are safe. Confusing the two destroys the answer to every distinguish-type question, where liability is the single most-marked axis.

## TOPIC

# Partnership registration

## TRAP → TRUTH

- × **MISTAKE** A partnership firm **MUST** be registered to be legal; an unregistered firm is illegal.
- ✓ **CORRECT** Registration of a partnership firm in India is **OPTIONAL**, not compulsory — an unregistered firm is perfectly legal and can do business. **BUT** non-registration carries serious **CONSEQUENCES**: an unregistered firm (or its partners) cannot file a suit against third parties or against other partners to enforce a claim, and cannot claim a set-off. Because of these disabilities, registration is strongly advisable. State that registration is optional but its absence disables the firm from suing — that nuance carries the marks.

## TOPIC

# Private vs public company

## TRAP → TRUTH

× **MISTAKE** A private company and a public company are basically the same — both have shareholders.

✓ **CORRECT** They differ on MEMBERS, share transfer, and public invitation. PRIVATE company: minimum 2, maximum 200 members; minimum 2 directors; RESTRICTS the transfer of shares; CANNOT invite the public to buy shares/debentures; uses 'Private Limited'. PUBLIC company: minimum 7 members, NO maximum; minimum 3 directors; shares FREELY transferable; CAN invite the public through a prospectus; uses 'Limited'. A One Person Company (OPC) is a special private company with a single member. These numbers and the share-transfer/public-invitation contrast are the highest-yield distinguishing points.

## TOPIC

# Company as the 'best' form

## TRAP → TRUTH

- × **MISTAKE** A joint stock company is always the best form because it can raise the most capital.
- ✓ **CORRECT** There is NO single best form — the choice **DEPENDS** on factors: cost and ease of formation (proprietorship cheapest, company costliest), liability, continuity, capital needed, degree of control wanted, and the nature of business. A small grocery is best as a sole proprietorship; a large steel plant needs a company. CBSE expects you to say the choice is situation-dependent and to justify it with the relevant factors, **NOT** to crown one form as universally best.

## TOPIC

# Karta in HUF business

## TRAP → TRUTH

- × **MISTAKE** All members of a Joint Hindu Family business have equal control and unlimited liability.
- ✓ **CORRECT** Control of an HUF business rests SOLELY with the KARTA (the eldest/senior-most male member, and, after recent legal developments, a senior female member too). Only the KARTA has UNLIMITED liability; all other members (coparceners) have LIMITED liability — limited to their share in the joint family property. Membership is by BIRTH in the family, not by agreement. Saying 'everyone has equal control and unlimited liability' confuses HUF with partnership.

## TOPIC

# Cooperative motive

## TRAP → TRUTH

- × **MISTAKE** A cooperative society is formed mainly to earn maximum profit for its members.
- ✓ **CORRECT** The primary motive of a cooperative is MUTUAL HELP and SERVICE to its members — 'each for all and all for each' — NOT profit maximisation. It is a voluntary association of at least 10 adults, registered under the Cooperative Societies Act, run on ONE-MEMBER-ONE-VOTE (democratic control, regardless of capital contributed), with limited liability and surplus distributed partly as a dividend on capital and bonus on patronage. Calling profit its main aim loses the defining feature.

## TOPIC

# Partner reward vs interest

## TRAP → TRUTH

× **MISTAKE** A sleeping (dormant) partner is not a real partner and gets no share of profit.

✓ **CORRECT** A SLEEPING / DORMANT partner DOES contribute capital and DOES share in profits and losses, and (in a general partnership) has UNLIMITED liability — they simply do not take part in the day-to-day MANAGEMENT and are not known to the public. They are full partners in every respect except active participation. Contrast them with a NOMINAL partner (lends only their name/reputation, contributes no capital, shares no profit) and a partner by estoppel/holding out (liable to third parties by their conduct). Mixing up sleeping and nominal partners is a frequent error.

TOPPER TEMPLATE · MARK-BY-MARK

# 6-mark: 'Explain the merits and limitations of a joint stock company.'

- |  |   |
|--|---|
| <p><b>1</b> <b>DEFINE + KEY FEATURE</b><br/>1 m</p>                    | <p>A JOINT STOCK COMPANY is an association of persons, formed under the Companies Act 2013, having a SEPARATE LEGAL ENTITY distinct from its members, PERPETUAL SUCCESSION, a common seal, and LIMITED LIABILITY of members.</p>  |
| <p><b>2</b> <b>MERIT — LIMITED LIABILITY</b><br/>1 m</p>               | <p>LIMITED LIABILITY: a shareholder's liability is limited to the unpaid amount on the shares held — personal assets are safe, which encourages people to invest.</p>   |
| <p><b>3</b> <b>MERITS — CAPITAL, CONTINUITY, TRANSFER</b><br/>1 m</p>  | <p>Large CAPITAL can be raised from the public; PERPETUAL SUCCESSION means the company continues despite death/insolvency of members; shares of a public company are FREELY TRANSFERABLE, giving liquidity to investors. Scope for managerial efficiency (professional managers) is high.</p> |
| <p><b>4</b> <b>LIMITATION — FORMATION &amp; REGULATION</b><br/>1 m</p> | <p>COMPLEX FORMATION: company formation is lengthy, costly, and involves many legal formalities; the company is subject to heavy government REGULATION and disclosure, reducing secrecy.</p>  |
| <p><b>5</b> <b>LIMITATION — SEPARATION &amp; CONFLICT</b><br/>1 m</p>  | <p>There is a SEPARATION of ownership and control — shareholders own but managers/directors control — which can cause oligarchic management and conflict of interest. Decision-making is slow.</p>  |

TOPPER TEMPLATE · MARK-BY-MARK

# 5-6 mark: 'Explain the different types of partners.'

- |   |  |
|---|--|
| <p><b>1</b> <b>ACTIVE PARTNER</b><br/>1 m</p>                               | <p>ACTIVE (working) partner: contributes capital, takes ACTIVE part in management, shares profits/losses, and has UNLIMITED liability. Must give public notice on retirement to escape future liability.</p>   |
| <p><b>2</b> <b>SLEEPING &amp; NOMINAL PARTNER</b><br/>1 m</p>               | <p>SLEEPING (dormant) partner: contributes capital and shares profit/loss with unlimited liability but does NOT participate in management and is unknown to the public. NOMINAL partner: lends only their NAME/ reputation, contributes no capital and takes no share of profit, but is liable to outsiders.</p> |
| <p><b>3</b> <b>PARTNER BY ESTOPPEL / HOLDING OUT</b><br/>1 m</p>            | <p>PARTNER BY ESTOPPEL: by words or conduct represents themselves as a partner and is thereby liable to anyone who gives credit on that belief. PARTNER BY HOLDING OUT: knowingly allows themselves to be represented as a partner and does not deny it, becoming liable to those who extend credit.</p>         |
| <p><b>4</b> <b>PARTNER IN PROFITS ONLY &amp; SECRET PARTNER</b><br/>1 m</p> | <p>PARTNER IN PROFITS ONLY: shares profits but not losses (used where a partner contributes capital but is shielded from losses). SECRET partner: participates in management but their membership is kept hidden from the public; still has unlimited liability.</p>   |
| <p><b>5</b> <b>MINOR AS A PARTNER</b><br/>1 m</p>                           | <p>A MINOR cannot be a full partner (no valid contract) but may be admitted to the BENEFITS of partnership with the consent of all partners; the minor's liability is LIMITED to their share and they are not personally liable.</p>   |

TOPPER TEMPLATE · MARK-BY-MARK

# 4-5 mark: 'Distinguish between a private company and a public company.'

- |     |                |  |  |
|-----|----------------|--|--|
| 1   | <b>MEMBERS</b> | PRIVATE company: minimum 2, maximum 200 members. PUBLIC company: minimum 7 members, with NO maximum limit. |  |
| 1 m | 2              | <b>DIRECTORS</b>   | PRIVATE company: minimum 2 directors. PUBLIC company: minimum 3 directors.   |
| 1 m | 3              | <b>TRANSFER OF SHARES</b>  | PRIVATE company: RESTRICTS the right to transfer its shares (by its articles). PUBLIC company: shares are FREELY transferable.   |
| 1 m | 4              | <b>INVITATION TO PUBLIC</b>  | PRIVATE company: CANNOT invite the public to subscribe to its shares or debentures. PUBLIC company: CAN invite the public through a prospectus.  |
| 1 m | 5              | <b>NAME &amp; INDEX OF MEMBERS</b>   | PRIVATE company: must add 'Private Limited' to its name and need not maintain an index of members. PUBLIC company: adds 'Limited' to its name and must maintain an index of members where membership exceeds 50. |
| 1 m |                |  |  |

**PYQ PATTERNS**

# Top PYQ patterns to drill

<b>#1</b>	Explain the merits and limitations of a joint stock company OR sole proprietorship. (5-6 marks)	Most terms
<b>#2</b>	Explain the types of partners / contents of a partnership deed / consequences of non-registration. (5-6 marks)	Annual
<b>#3</b>	Distinguish between a private company and a public company (or sole proprietorship and partnership). (4-5 marks)	Annual
<b>#4</b>	Explain the features and any 3-4 types of a cooperative society. (4-5 marks)	Most terms
<b>#5</b>	What factors determine the choice of a form of business organisation? OR Who is a Karta? (3-4 marks)	Most terms

RECAP · MEMORISE THESE

# Recap

**1** Five forms — Sole proprietorship · Joint Hindu Family (Karta) · Partnership (general/limited/LLP) · Cooperative society · Joint stock company (private/public/OPC).

**2** Liability — UNLIMITED in sole prop and general partnership (and the HUF Karta); LIMITED in cooperative, LLP and company — the most-marked axis in every comparison.

**3** Partnership — Indian Partnership Act 1932; deed = written agreement; registration optional but unregistered firm cannot sue; many types of partners; mutual agency is the key test.

ready  
**4**

## WHAT'S NEXT

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# What's next

- Chapter 3 — Private, Public and Global Enterprises.
- Sit the 15-MCQ Quick Drill.
- Then the full annual-pattern paper — 30 marks.

# You've mastered Chapter 2 of Business Studies.

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