

1. Details of Module and its structure

Module Detail	
Subject Name	Business Studies
Course Name	Business Studies 01 (Class XI, Part- 1)
Module Name/Title	Forms of Business Organisation/ Sole Proprietorship – Part 1
Module Id	kebs_10201
Pre-requisites	Knowledge about Forms of Business Organisation/ Sole Proprietorship
Objectives	<p>After going through this lesson, the learners will be able to understand the following:</p> <ul style="list-style-type: none">• Introduction of forms of Business Organization• Sole Proprietorship - Meaning• Features of Sole Proprietorship• Merits and Limitations of Sole Proprietorship
Keywords	Sole Proprietorship, Ownership, Liability, Profits, Losses

2. Development Team

Role	Name	Affiliation
National MOOC Coordinator	Prof. Amarendra P. Behera	CIET, NCERT, New Delhi
Program Coordinator	Dr. Rejaul Karim Barbhuiya	CIET, NCERT, New Delhi
Course Coordinator (CC) / PI	Dr. Punnam Veeraiah	CIVE, RIE Campus, Bhopal
Course Co-Coordinator / Co-PI	Dr. Nidhi Gusain	CIET, NCERT, New Delhi
Subject Matter Expert (SME)	Mrs. Madhu Vaswani	Delhi Public School, Mathura Road, New Delhi
Review Team	Dr. Munipalle Usha	UPGC, Osmania University, Hyderabad
Technical Team	Mr. Shobit Saxena Ms. Khushboo Sharma	CIET, NCERT, New Delhi CIET, NCERT, New Delhi

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Introduction:

Most production and distribution activities are carried out by millions of people in different parts of the country by constituting various kinds of organizations.

A business entity is an organization that uses economic resources to provide goods or services to customers in exchange for money or other goods and services.

One of the first decisions you'll make as a business owner is **how your business will be structured**. You need to know the advantages and disadvantages of each of the **different forms of business organization** to make sure you make the right decision for your new business.

Business organization is the single-most important choice you'll make regarding your company. What form your business adopts will affect a multitude of factors, many of which will decide your company's future. Aligning your goals to your business organization type is an important step, so understanding the pros and cons of each type is crucial.

These organizations are based on some form of ownership. This choice affects a number of managerial and financial issues, including the amount of taxes the entrepreneur would have to pay, whether the entrepreneur may be personally sued for unpaid business bills, and whether the venture will die automatically with the demise of the entrepreneur.

All businesses must adopt some **legal configuration that defines the rights and liabilities** of participants in the business's **ownership, control, personal liability, lifespan and financial structure**. The form of business determines which **income tax return form to file and the company's and owner's legal liabilities**.

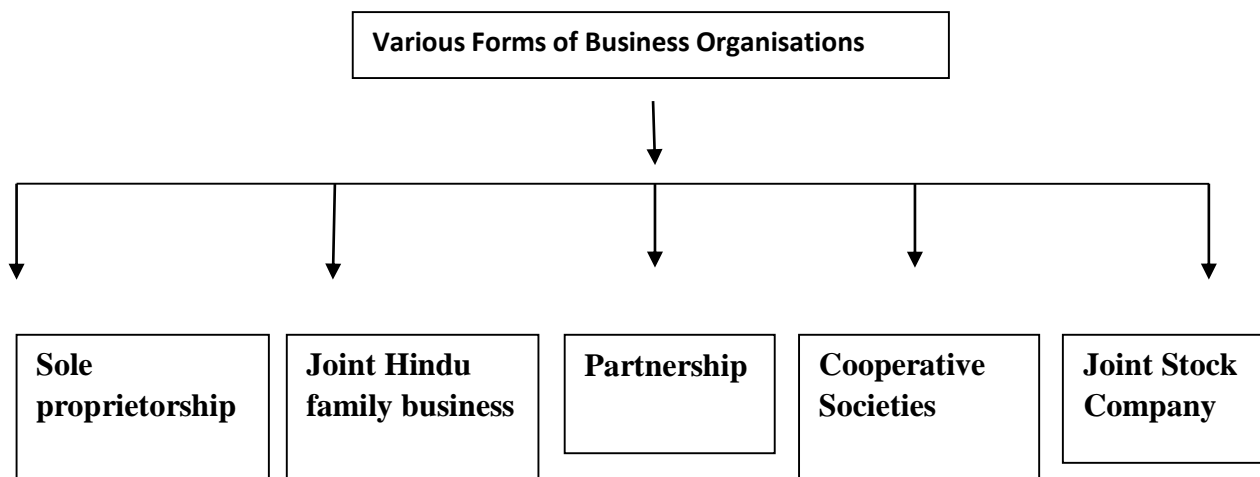
This is a big decision that has long-term implications, so if you're unsure of which form of business is best for your company, consult a professional.

When you decide about the form of your new business, account for the following:

- Your (practical) vision regarding the size and nature of your business.
- The level of control you wish to have.
- The level of “structure” you are willing to deal with.
- The business’s vulnerability to lawsuits.
- Tax implications of the different organizational structures.
- Expected profit (or loss) of the business.

So, if one is planning to start a business or is interested in expanding an existing one, an important decision relates to the choice of the form of organisation. The most appropriate form is determined by weighing the advantages and disadvantages of each type of organisation against one’s own requirements. Various forms of business organisations:

- (a) Sole proprietorship,
- (b) Joint Hindu family business,
- (c) Partnership
- (d) Cooperative Societies, and
- (e) Joint Stock Company.



Let us start our discussion with sole proprietorship — the simplest form of business organisation, and then move on to analysing more complex forms of organisations.

Sole Proprietorship: Meaning

Do you often go in the evenings to buy registers, pens, chart papers, etc., from a small neighbourhood stationery store? Well, in all probability in the course of your transactions, you

have interacted with a sole proprietor. Sole proprietorship is a popular form of business organisation and is the most suitable form for small businesses, especially in their initial years of operation. Sole proprietorship refers to a form of business organisation which is owned, managed and controlled by an individual who is the recipient of all profits and bearer of all risks. This is evident from the term itself. The word “sole” implies “only”, and “proprietor” refers to “owner”. Hence, a sole proprietor is the one who is the only owner of a business. This form of business is particularly common in areas of personalised services such as beauty parlours, hair salons and small scale activities like running a retail shop in a locality.

A sole proprietorship is very different from corporations and limited partnerships, in that no separate legal entity is created. As a result, the business owner of a sole proprietorship is not exempt from liabilities incurred by the entity.

For example, the debts of the sole proprietorship are also the debts of the owner. However, the profits of the sole proprietorship are also the profits of the owner, as all profits flow directly to the business's owner. It begins as an entity with unlimited liability. As a business grows, it often transitions to a limited liability company.

The business' existence is entirely dependent on the owner's decisions, so when the owner dies, so does the business.

The vast majority of small businesses start out as sole proprietorships. These firms are owned by one person, usually the individual who has day-to-day responsibility for running the business. Sole proprietorships own all the assets of the business and the profits generated by it. They also assume complete responsibility for any of its liabilities or debts. In the eyes of the law and the public, you are one in the same with the business

Sole proprietorship or individual entrepreneurship is a business concern owned and operated by one person. The sole proprietor is a person who carries on business exclusively by and for himself. He alone contributes the capital and skills and is solely responsible for the results of the enterprise. In fact sole proprietor is the supreme judge of all matters pertaining to his business subject only to the general laws of the land and to such special legislation as may affect his particular business.

A sole proprietor is the unquestioned king of his venture. He owns it. He controls it from the word go. He provides the needed resources and launches the enterprise on his own. He burns up his candle of energies on everything. He brings his skills, knowledge and expertise to the

table. He plans every step. He hires people, if additional hands are required. He interacts with customers and does everything possible to please them.

In a sole proprietorship business there is only ONE owner. There may be employees or helpers assisting and reporting to the owner, but there is only one “head” who administers and runs the show. It is a business enterprise exclusively owned, managed and controlled by a single person with all authority, responsibility and risk.

One of the great features of a sole proprietorship is the simplicity of formation. Little more than buying and selling goods or services is needed. In fact, no formal filing or event is required to form a sole proprietorship; it is a status that arises automatically from one's business activity.

Features

Salient features/characteristics of the sole proprietorship form of organisation are as follows:

i) Formation and closure: There is no separate law that governs sole proprietorship. Hardly any legal formalities are required to start a sole proprietary business, though in some cases one may require a license. Closure of the business can also be done easily. Thus, there is ease in formation as well as closure of business.

ii) Liability: Sole proprietors have unlimited liability. This implies that the owner is personally responsible for payment of debts in case the assets of the business are not sufficient to meet all the debts. As such the owner's personal possessions such as his/her personal car and other assets could be sold for repaying the debt. Suppose the total outside liabilities of XYZ dry cleaner, a sole proprietorship firm, are Rs. 80,000 at the time of dissolution, but its assets are Rs. 60,000 only. In such a situation the proprietor will have to bring in Rs. 20,000 from her personal sources even if she has to sell her personal property to repay the firm's debts.

iii) Sole risk bearer and profit recipient: The risk of failure of business is borne all alone by the sole proprietor. However, if the business is successful, the proprietor enjoys all the benefits. He receives all the business profits which become a direct reward for his risk bearing.

iv) Control: The right to run the business and make all decisions lies absolutely with the sole proprietor. He can carry out his plans without any interference from others.

v) No separate entity: In the eyes of the law, no distinction is made between the sole trader and his business, as business does not have an identity separate from the owner. The owner is, therefore, held responsible for all the activities of the business.

vi) Lack of business continuity: The sole proprietorship business is owned and controlled by one person, therefore death, insanity, imprisonment, physical ailment or bankruptcy of the sole proprietor will have a direct and detrimental effect on the business and may even cause closure of the business.

Merits:

Sole proprietorship offers many advantages. Some of the important ones are as follows:

i) Quick decision making: A sole proprietor enjoys considerable degree of freedom in making business decisions. Further the decision making is prompt because there is no need to consult others. This may lead to timely capitalisation of market opportunities as and when they arise.

ii) Confidentiality of information: Sole decision making authority enables the proprietor to keep all the information related to business operations confidential and maintain secrecy. A sole trader is also not bound by law to publish firm's accounts.

iii) Direct incentive: A sole proprietor directly reaps the benefits of his/her efforts as he/she is the sole recipient of all the profit. The need to share profits does not arise as he/she is the single owner. This provides maximum incentive to the sole trader to work hard.

iv) Sense of accomplishment: There is a personal satisfaction involved in working for oneself. The knowledge that one is responsible for the success of the business not only contributes to self-satisfaction but also instils in the individual a sense of accomplishment and confidence in one's abilities.

v) Ease of formation and closure: An important merit of sole proprietorship is the possibility of entering into business with minimal legal formalities. There is no separate law that governs sole proprietorship. As sole proprietorship is the least regulated form of business, it is easy to start and close the business as per the wish of the owner.

Some other advantages of Sole Proprietorship:

vi) Simplicity: It is very easy to establish and dissolve a sole proprietorship. No documents are required and no legal formalities are involved. Any person competent to enter into a contract can start it. However, in some cases, i.e., of a chemist shop, a municipal license has to be obtained. You can start business from your own home.

vii) Personal Touch: The proprietor can maintain personal contacts with his employees and clients. Such contacts help in the growth of the enterprise.

viii) Flexibility: In the absence of Government control, there is complete freedom of action. There is no scope for difference of opinion and no problem of co-ordination.

Limitations:

Notwithstanding various advantages, the sole proprietorship form of organisation is not free from limitations. Some of the major limitations of sole proprietorship are as follows:

i) Limited resources: Resources of a sole proprietor are limited to his/her personal savings and borrowings from others. Banks and other lending institutions may hesitate to extend a long term loan to a sole proprietor. Lack of resources is one of the major reasons why the size of the business rarely grows much and generally remains small. As a result the size of business remains small. There is limited scope for growth and expansion. Economies of scale are not available. A sole trader is also not bound by law to publish firm's accounts.

ii) Limited life of a business concern: The sole proprietorship business is owned and controlled by one person, so death, insanity, imprisonment, physical ailment or bankruptcy of a proprietor affects the business and can lead to its closure.

iii) Unlimited liability: A major disadvantage of sole proprietorship is that the owner has unlimited liability. If the business fails, the creditors can recover their dues not merely from the business assets, but also from the personal assets of the proprietor. A poor decision or an unfavourable circumstance can create serious financial burden on the owner. That is why a sole proprietor is less inclined to take risks in the form of innovation or expansion. Sole proprietors are personally liable for all debts of a sole proprietorship business. Let's examine this more closely because the potential liability can be alarming. Assume that a sole proprietor borrows

money to operate but the business loses its major customer, goes out of business, and is unable to repay the loan. The sole proprietor is liable for the amount of the loan, which can potentially consume all her personal assets.

iv) Limited managerial ability: Proprietorship is a one man show and one man cannot be an expert in all areas (production, marketing, financing, personnel etc.) of business. The owner has to assume the responsibility of varied managerial tasks such as purchasing, selling, financing, etc. It is rare to find an individual who excels in all these areas. Thus decision making may not be balanced in all the cases. Also, due to limited resources, sole proprietor may not be able to employ and retain talented and ambitious employees.

Suitability of Sole Proprietorship form of Organisation:

Though sole proprietorship suffers from various shortcomings, entrepreneurs opt for this form of organisation especially start up founders because of its inherent advantages. It requires less amount of capital. It is best suited for businesses which are carried out on a small scale and where customers demand personalised services. It also suits to the businesses where manual skills are required or where the capital required to start the business is relatively small and does not involve a high degree of risk.

Sole proprietorship is suitable in the following cases:

- i. Where small amount of capital is required e.g., sweet shops, bakery, newsstand, etc.
- ii. Where quick decisions are very important.
- iii. Where limited risk is involved, e.g., automobile repair shop, confectionery, small retail store, etc.
- iv. Where personal attention to individual tastes and fashions of customers is required, e.g., beauty parlour, tailoring shops, lawyers, painters, etc.
- v. Where the demand is local, seasonal or temporary, e.g., retail trade, laundry, fruit sellers, etc.
- vi. Where fashions change quickly, e.g., artistic furniture, etc.
- vii. Where the operation is simple and does not require skilled management.

Thus, sole proprietorship is a common form of organisation in retail trade, professional firms, household and personal services. This form of organization is quite popular in our country. It accounts for the largest number of business establishments in India, in spite of its limitations.

Expansion of Business:

When the business of a proprietor expands, he has either to employ a manager or take a partner to handle the problems of capital and management.

Key Takeaways:

- A sole proprietorship is an unincorporated business with only one owner who pays personal income tax on profits earned.
- Sole proprietorships are easy to establish and dismantle, due to a lack of government involvement, making them popular with small business owners and contractors.
- It has no separate legal identity. There is no need for incorporation and the not many procedures to be done. Opening a bank account and obtaining a license (if necessary) are mostly the only steps involved.

Summary with revision of some important terms:

A business entity is an organization that uses economic resources to provide goods or services to customers in exchange for money or other goods and services.

You need to know the advantages and disadvantages of each of the **different forms of business organization** to make sure you make the right decision for your new business.

When you decide about the form of your new business, account for the following:

- Your (practical) vision regarding the size and nature of your business
- The level of control you wish to have
- The level of “structure” you are willing to deal with
- The business’s vulnerability to lawsuits
- Tax implications of the different organizational structures
- Expected profit (or loss) of the business

Various forms of business organisations from which one can choose the right one include:

- (a) Sole proprietorship,
- (b) Joint Hindu family business,
- (c) Partnership
- (d) Cooperative Societies, and
- (e) Joint Stock Company.

Sole Proprietorship: Meaning:

Sole proprietorship refers to a form of business organisation which is owned, managed and controlled by an individual who is the recipient of all profits and bearer of all risks. This is evident from the term itself. The word “sole” implies “only”, and “proprietor” refers to “owner”. Hence, a sole proprietor is the one who is the only owner of a business.

In a sole proprietorship business there is only ONE owner. It is a business enterprise exclusively owned, managed and controlled by a single person with all authority, responsibility and risk.

Features

Salient features/characteristics of the sole proprietorship form of organisation are as follows:

- i) Formation and closure
- ii) Liability
- iii) Sole risk bearer and profit recipient
- iv) Control
- v) No separate entity
- vi) Lack of business continuity

Merits:

Sole proprietorship offers many advantages. Some of the important ones are as follows:

- i) Quick decision making
- ii) Confidentiality of information
- iii) Direct incentive
- iv) Sense of accomplishment
- v) Ease of formation and closure

Some other advantages of Sole Proprietorship:

- vi) Simplicity
- vii) Personal Touch:
- viii) Flexibility

Limitations:

Some of the major limitations of sole proprietorship are as follows:

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- i) Limited resources
 - ii) Limited life of a business concern
 - iii) Unlimited liability
 - iv) Limited managerial ability

Suitability of Sole Proprietorship form of Organisation:

Sole proprietorship is suitable in the following cases:

- i. Where small amount of capital is required e.g., sweet shops, bakery, newsstand, etc.
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