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/ Partnership – Part 3
Module Id	kebs_10203
Pre-requisites	Knowledge about sole proprietorship form of business organisation
Objectives	After going through this lesson, the learners will be able to understand the following: • Partnership – Meaning • Features of Partnership • Merits of Partnership • Limitations of Partnership
Keywords	Partnership, Unlimited Liability, Sharing of Profits and losses, Control, Finance

2. Development Team

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When we talk about the forms a business organisation can take, one of the most prominent ones is a partnership. In India particularly it is a very popular entity to carry out business.

Meaning of ‘Partnership’

A partnership is a formal arrangement by two or more parties to manage and operate a business and share its profits.
So in such a case two or more persons come together as a unit to achieve some common objective. And the profits earned in pursuit of this objective will be shared amongst themselves.

The inherent disadvantage of the sole proprietorship in financing and managing an expanding business paved the way for partnership as a viable option. Partnership serves as an answer to the needs of greater capital investment, varied skills and sharing of risks.

In India, we have a definite law that covers all aspects and functioning of a partnership, The Indian Partnership Act 1932. The act defines a partnership as “the relation between two or more persons who have agreed to share the profits from a business carried on by either all of them or any of them on behalf of/acting for all”

A partnership is a form of business where two or more people share ownership, as well as the responsibility for managing the company and the income or losses the business generates. That income is paid to partners in the form of profits.

In a **Broad sense**, a partnership can be any endeavour undertaken jointly by multiple parties. The parties may be

- governments,
- non-profits enterprises,
- businesses, or
- private individuals.

The goals of a partnership also vary widely.

Within the **Narrow sense** of a for-profit venture undertaken by two or more individuals, there are three main categories of partnership:

- General partnership,
- Limited partnership, and
- Limited liability limited partnership.

There are several types of partnership arrangements. In particular, in a partnership business, all partners share liabilities and profits equally, while in others, partners have limited liability. There is also is a type of partner called "silent partner," in which one party is not involved in the day-to-day operations of the business.
We will study about all this in detail in the next module.

Following are some **key take away of partnership:**

- A partnership is an arrangement between two or more people to oversee business operations and share its profits and liabilities.
- In a general partnership company, all members share both profits and liabilities.
- Professionals like doctors and lawyers often form a limited partnership.

Features of Partnership

Following are the major characteristics/features of the partnership form of business organisation:

i) Formation: The partnership form of business organisation is governed by the Indian Partnership Act, 1932. It comes into existence through a legal agreement wherein the terms and conditions governing the relationship among the partners, sharing of profits and losses and the manner of conducting the business are specified. It may be pointed out that the business must be lawful and run with the motive of profit. Thus, two people coming together for charitable purposes will not constitute a partnership. Similarly, a partnership contract to carry out illegal work, such as smuggling, is void as well.
A partnership firm is not a separate legal entity. But according to the act, a firm must be formed via a legal agreement between all the partners. So a contract must be entered into to form a partnership firm.

ii) **Liability**: Partners are jointly and severally responsible for all the debts and obligations of the business without any limit, including loss and damages arising from wrongful acts or omissions of their fellow partners and potential liability to third parties. They have unlimited liability. Personal assets may be used for repaying debts in case the business assets are insufficient. Further, the partners are jointly and individually liable for payment of debts. Jointly, all the partners are responsible for the debts and they contribute in proportion to their share in business and as such are liable to that extent. Individually too, each partner can be held responsible repaying the debts of the business. However, such a partner can later recover from other partners an amount of money equivalent to the shares in liability defined as per the partnership agreement. It means if the money is recovered from a single partner, he can, in turn, sue the other partners for their share of the debt as per the contract of the partnership. Partners are jointly and severally responsible for all the debts and obligations of the business without any limit, including loss and damages arising from wrongful acts or omissions of their fellow partners and potential liability to third parties.

iii) Risk bearing: The partners bear the risks involved in running a business as a team. The reward comes in the form of profits which are shared by the partners in an agreed ratio. However, they also share losses in the same ratio in the event of the firm incurring losses. Each partner is entitled to share the net profits of the business. A contract need not necessarily provide for equal shares. It may depend upon how much the partner has invested.

iv) Decision making and control: Partners have the right to make the decisions that affect the business or the business assets. They share amongst themselves the responsibility of decision making and control of day to day activities. Decisions are generally taken with mutual consent. Thus, the activities of a partnership firm are managed through the joint efforts of all the partners.

v) Continuity: Partnership is characterised by lack of continuity of business since the death, retirement, insolvency or insanity of any partner can bring an end to the business. However, the remaining partners may if they so desire continue the business on the basis of a new agreement. Also, the partnership of a father cannot be inherited by his son. If all the other partners agree, he can be added on as a new partner.

vi) Number of Partners: The minimum number of partners needed to start a partnership firm is two. According to section 464 of the Companies Act 2013, maximum number of partners in a partnership firm can be 100, subject to the number prescribed by the government. As per Rule

10 of The Companies (miscellaneous) Rules 2014, at present the maximum number of members can be 50.

(vii) Mutual agency: The definition of partnership highlights the fact that it is a business carried on by all or any one of the partners acting for all.

In other words, every partner is both an agent and a principal. He is an agent of other partners as he represents them and thereby binds them through his acts. He is a principal as he too can be bound by the acts of other partners.

In a partnership, the business must be carried out by all the partners together. Or alternatively, it can be carried out by any of the partners (one or several) acting for all of them or on behalf of all of them. So this means every partner is an agent as well as the principal of the partnership. He represents the other partners in some cases so he is their agent. But in other circumstances, he is bound by the actions of any of the other partners asking him the principal as well.

viii) Privacy – The financial and constitutional matters of the partnership are entirely private. Disclosure is governed by the partners' interests.

Merits of Partnership:

Following are the major merits/advantages of the partnership form of business organisation:

i) Ease of formation and closure: A partnership firm can be formed easily by putting an agreement between the prospective partners into place whereby they agree to carry out the business of the firm and share risks. Although it will take longer and incur additional cost, it’s usually sensible to put in place a partnership agreement. This documents how the partnership will work, the rights and responsibilities of partners and what would happen in various possible situations, including if the partners fundamentally disagree or someone wants to leave.

There is no compulsion with respect to registration of the firm. Closure of the firm too is an easy task. Unless a formal partnership agreement has been drawn up, a partnership business can easily be dissolved at any time: this gives each partner the freedom to choose to leave if they wish to.

ii) Balanced decision making: The partners can oversee different functions according to their areas of expertise. Because an individual is not forced to handle different activities, this not only reduces the burden of work but also leads to fewer errors in judgements. As a consequence, decisions are likely to be more balanced.

iii) More funds: In a partnership, the capital is contributed by a number of partners. This makes it possible to raise larger amount of funds as compared to a sole proprietor and undertake additional operations when needed.

iv) Sharing of risks: The risks involved in running a partnership firm are shared by all the partners. This reduces the anxiety, burden and stress on individual partners.

v) Secrecy: A partnership firm is not legally required to publish its accounts and submit its reports. Hence it is able to maintain confidentiality of information relating to its operations. The affairs of a partnership business can be kept confidential by the partners.

vi) Less formal with fewer legal obligations: One of the main advantages of a partnership business is the lack of formality compared with managing a limited company.
The accounting process is generally simpler for partnerships than for limited companies. There are fewer records to maintain. A partnership business does not need to maintain a set of statutory books like a limited company has to.
Unless a formal partnership agreement has been drawn up, a partnership business can easily be dissolved at any time: this gives each partner the freedom to choose to leave if they wish to.

vii) More partners, more capital: The more partners there are, the more money there may be available from their combined resources to invest into the business, which can help to fuel growth. Together, their borrowing capacity is also likely to be greater.

viii) Access to knowledge, skills, experience and contacts: Each partner will bring their own knowledge, skills, experience and contacts to the business, potentially giving it a better chance of success than any of the partners trading individually.
Partners can share out tasks, with each specialising in areas they're best at and enjoy most. So if one partner has a financial background, they could focus on maintaining the firm's books, while another may have previously worked extensively in sales and therefore take ownership of that side of the business. As a sole trader, by contrast, you'd have to do all of this yourself (or manage someone you employ to do some of it).

ix) Ownership and control are combined: By contrast, in a business partnership, the partners both own and control the business. As long as the partners can agree how to operate and drive forward the partnership, they're free to pursue that without interference from anyone else. This can make a partnership business potentially more flexible than a limited company, with the ability to adapt more quickly to changing circumstances.

Limitations of Partnership:

Following are the major limitations/disadvantages of the partnership form of business organisation:

i) Unlimited liability: Partners are liable to repay debts even from their personal resources in case the business assets are not sufficient to meet its debts. The liability of partners is both joint and several which may prove to be a drawback for those partners who have greater personal wealth. They will have to repay the entire debt in case the other partners are unable to do so.

ii) Limited resources: There is a restriction on the number of partners, and hence contribution in terms of capital investment is usually not sufficient to support large scale business operations. As a result, partnership firms face problems in expansion beyond a certain size.

iii) Possibility of conflicts: Partnership is run by a group of persons wherein decision making authority is shared. Difference in opinion on some issues may lead to disputes between partners. Further, decisions of one partner are binding on other partners. An unwise decision by someone may result in financial ruin for all others. In case a partner desires to leave the firm, this can result in termination of partnership as there is a restriction on transfer of ownership.

iv) Lack of continuity: Partnership comes to an end with the death retirement, insolvency or lunacy of any partner. It may result in lack of continuity. However, the remaining partners can enter into a fresh agreement and continue to run the business.

v) Lack of public confidence: A partnership firm is not legally required to publish its financial reports or make other related information public. It is, therefore, difficult for any member of the public to ascertain the true financial status of a partnership firm. As a result, the confidence of the public in partnership firms is generally low. Especially given their lack of independent existence aside from the partners themselves, partnerships can appear to be temporary enterprises, although many partnerships are in fact very long-lasting.

This appearance of impermanence, and the fact that the partnership's financials cannot be independently checked at Companies House, can appear to present more risk. Because of this, some clients (more so in certain industries) will refuse to transact with a partnership business.

vi) The business has no independent legal status: A business partnership has no independent legal existence distinct from the partners. Even if a partnership agreement is in place, the remaining partners may not be in a position to purchase the outgoing partner's share of the business. In that case, the business will likely still need to be dissolved.

vii) Limited access to capital: While a combination of partners is likely to be able to contribute more capital than a sole trader, a partnership will often still find it difficult to raise money. Banks may prefer the greater accounting transparency, separate legal personality and sense of permanence that a limited company provides. To the extent that a partnership business is seen as higher risk, a bank will either be unwilling to lend or will only do so on less generous terms. Several other forms of long-term finance are not available to partnerships. Most importantly, they cannot issue shares or other securities in exchange of money.

viii) Slower, more difficult decision making: Compared to running a business as a sole trader, decision-making can be slower as you'll need to consult and discuss matters with your partners. Where you disagree, time will be spent negotiating to build agreement or consensus. Sometimes this might mean opportunities are missed. More often, it will frustrate a partner who has been used to making all the decisions for their business.

ix) Profits must be shared: At a basic level, while a sole trader retains all the profits of their business, those of a partnership are shared amongst the partners.
Sharing profits equitably can raise difficult questions. How do you value different partners' respective skills? What happens when one partner is seen to be putting in less time and effort into the partnership, but still taking their share of the profits? It's easy for resentment to occur if there doesn't appear to be a fair balance between effort and reward.

x) Limits on business development: Any business looking to achieve massive growth, a combination of unlimited liability, lack of funding opportunities and a lack of commercial status in the eyes of the world is hardly the perfect recipe for success.

Summary

Meaning of ‘Partnership’:

A partnership is a formal arrangement by two or more parties to manage and operate a business and share its profits.
The Indian Partnership Act 1932 defines a partnership as “the relation between two or more persons who have agreed to share the profits from a business carried on by either all of them or any of them on behalf of/acting for all”

Following are the Features of Partnership:
i) Formation
ii) Liability
iii) Risk bearing
iv) Decision making and control
v) Continuity
vi) Number of Partners
vii) Mutual agency
viii) Privacy

Merits of Partnership:
Following are the major merits/advantages of the partnership form of business organisation:
i) Ease of formation and closure
ii) Balanced decision making
iii) More funds
iv) Sharing of risks
v) Secrecy
vi) Less formal with fewer legal obligations
vii) More partners, more capital
viii) Access to knowledge, skills, experience and contacts
ix) Ownership and control are combined

Next we discussed the **Limitations of Partnership**:
Following are the major limitations/disadvantages of the partnership form of business organisation:

i) Unlimited liability

ii) Limited resources

iii) Possibility of conflicts

iv) Lack of continuity

v) Lack of public confidence

vi) The business has no independent legal status

vii) Limited access to capital

viii) Slower, more difficult decision making

ix) Profits must be shared

x) Limits on business development.