

3

Business Organizations



The following facts are discussed in this chapter.

- 3.1 Basic information on the types of business organizations
 - Classification of business organizations
 - Types of business organizations and their characteristics
- 3.2 Selecting an appropriate business organization
 - According to the objectives
 - According to the scale
 - According to the management procedures
- 3.3 Registration of a Sole Proprietorship
 - Steps to be followed for registration
 - Documents needed for registration
 - Advantages of registering the business name

3.1 Basic information on the types of business organizations

When the population of a country is increasing, the process of manufacturing and distributing goods and services has expanded. Therefore, different types of business organizations are established in order to fulfill the needs and wants of people. A business organization consists of an individual or a group of individuals working together to produce goods and services required to fulfill human needs and wants.

Different parties provide funds to businesses. The owners of a business are the individuals or groups who provide funds and assume the risk by involving in business. Based on the ownership, businesses are categorized into several categories.

In addition, businesses are conducted to achieve different objectives of the businessmen. Accordingly, some businesses are carried out to earn profits whereas others are carried out for the well-being of the society.

Further, a businessman can start either a small scale business or a large scale business depending on the amount of resources that he has. Out of different types of business organizations, businessmen should be clever enough to choose an appropriate type.

Classification of business organizations

Businesses are organized in different ways. These different types of business organizations can be classified as follows depending on various criteria.

- ✦ Based on the ownership
- ✦ Based on the objective
- ✦ Based on the scale

Classification of business organizations based on the ownership

The owners are the individuals who provide funds for the business and assume risks by involving in it. The owners enjoy the profits earned by the business and bear the losses of the business as well. Accordingly, business organizations can be categorized as follows based on their ownership.

- ✦ Private sector business organizations
- ✦ Public sector business organizations

The figure 3.1 depicts different ways of classifying business organizations under above two sectors based on ownership.

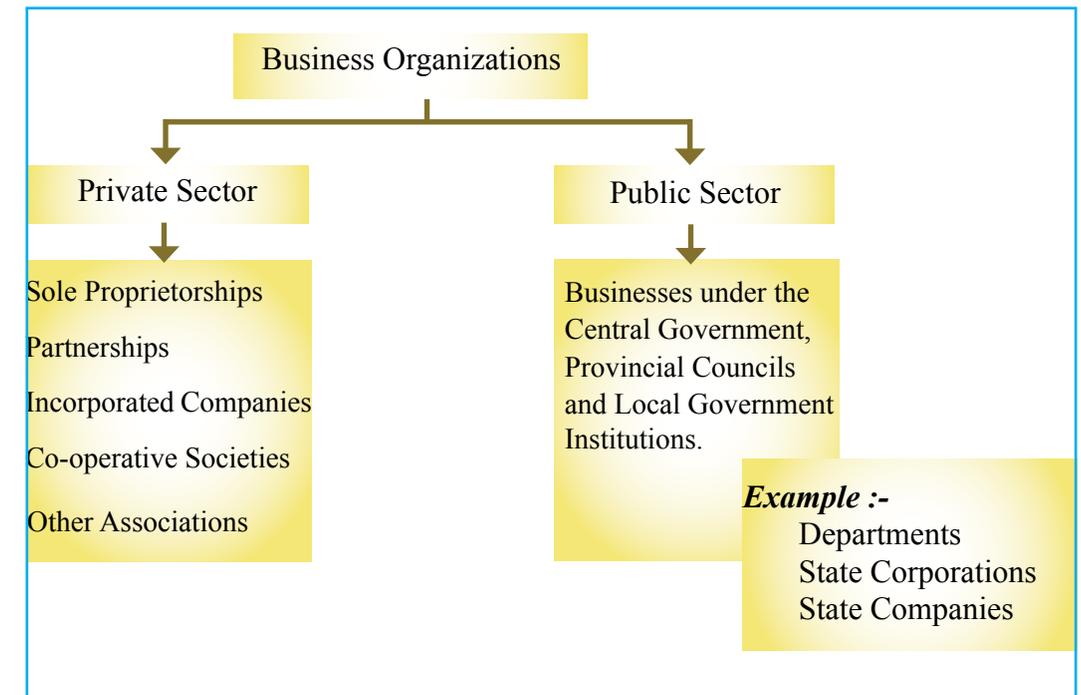


Figure 3.1 Classification of business organizations based on the ownership

Private sector business organizations

Businesses owned by an individual or a group of individuals are known as private sector businesses. Private sector businesses can be further classified as sole proprietorship, partnerships, incorporated companies, cooperative societies and other associations.

Public sector business organizations

Businesses funded and owned by the government are public sector business organizations. State departments, state corporations, state companies, businesses registered and owned under Provincial Councils and Local Government Institutions are the different types of business organizations in the public sector.

Classification of business organizations based on the objectives

Different organizations are established to achieve different objectives. Businesses are also conducted by its owners to achieve an objective. Businesses can be classified as follows based on its objective.

- ✦ For profit businesses
- ✦ Not for profit businesses

The below Figure 3.2 depicts the classification of business organizations based on the objective.

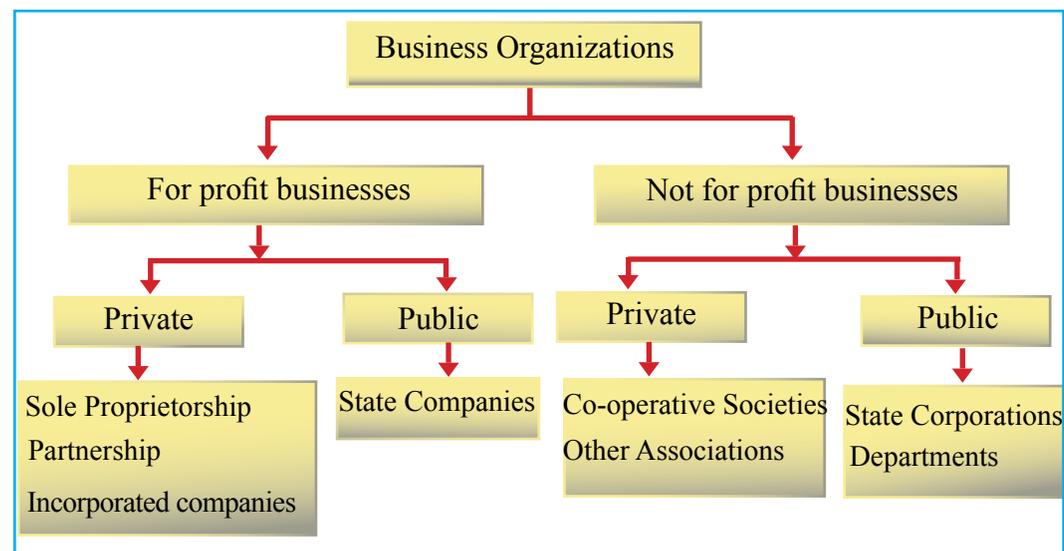


Figure 3.2 Classification of business organizations based on the objective

For profit businesses

When the main objective of the business is to earn profits, they are known as profit oriented businesses. This type of businesses are operated under both private sector and public sector.

Not for profit businesses

The main objective of these businesses is to ensure welfare of members and the society. Not for profit businesses are also conducted both under private sector and public sector.

Classification of business organizations based on the scale

The scale of a business organization depends on different criteria. Some of the criteria used as follows.

- ✦ Amount of capital invested in a business
- ✦ Number of employees
- ✦ Amount of the energy used
- ✦ Market share of the business

Based on the scale, business organizations can be categorized into two parts.

- ✦ Small and medium scale businesses
- ✦ Large scale businesses

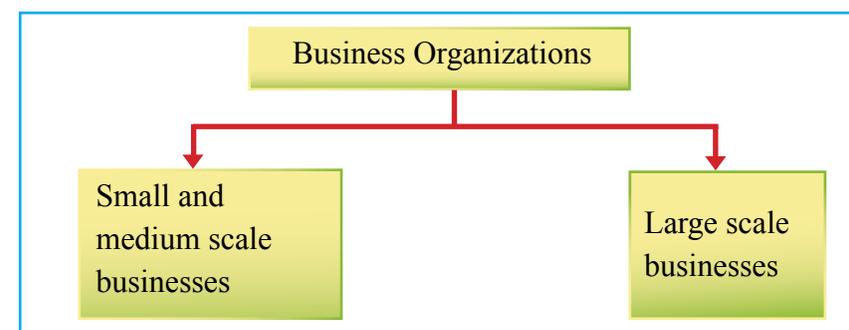


Figure 3.3 Classification of business organizations based on scale

Small and medium scale businesses

Different institutions have identified different criteria in classifying small and medium scale businesses. Accordingly, businesses with a small amount of capital invested, with a small number of employees and having a small market share relative to large scale businesses are known as small and medium scale businesses.



Figure 3.4

Example :-

Businesses employing less than 25 employees according to the Census and Statistics Department are considered as small scale businesses.

Large scale businesses

Businesses that have invested a large amount of capital, have employed a large number of employees, have a large market share and have the ability to influence the respective industry are known as large scale businesses.



Figure 3.5

Example :-

A factory employing a large number of workers

Next, the above mentioned business organisations will be discussed in detail.

Sole proprietorship

Businesses owned by an individual are known as sole proprietorship. This is the most common type of business organization in almost all the countries in the world. This type of business organization is common because it is easy to commence, requires only a small amount of capital and can take independent decisions. The success of this business depends on the skills and dedication of its owner.



Figure 3.6 - A small retail shop

Characteristics of sole proprietorship

The following characteristics can be seen in sole proprietorship.

* Capital is provided by a single person who is the owner

The owner is required to find the necessary capital for the business individually. Savings or borrowed funds by the owner can be invested as the capital to the business.

* Profits or losses to be born alone

All the profits earned by a sole proprietorship belong to the owner. Also, if there is a loss, the owner should bear it alone.

* Unlimited liability of the owner

In a sole proprietorship, the owners' liability is unlimited. Accordingly, the liability is not limited only for the capital that had been invested. In order to settle liabilities of the business, the owner might require to use his properties external to the business and there is no limit for such commitment.

* No legal personality

A sole proprietorship cannot conduct any legal operations by its business name. It can do so only by the personal name of the owner. For example, entering in to contracts, purchase of vehicles, obtaining bank loan, filing cases should be done in the personal name of the owner.

* No continued existence

Due to such reasons as the death of the owner, being mentally unsound to conduct the business etc. the business operations of a sole proprietorship will be discontinued.

* Not mandatory to register

In general, it is not mandatory to register a sole proprietorship.

In addition to the above mentioned characteristics, there are some other characteristics of a sole proprietorship such as the ability to take decisions alone, controlling is done by the owner and owner has the opportunity to discontinue the business at any time he requires.

Advantages of sole proprietorship businesses

Sole proprietorship have following main advantages compared to other types of business organizations.

* Convenient to start

Since the legal requirements are minimal and the cost of establishing is low compared to other business organizations, it is easy to commence a sole proprietorship.

- ★ **All the profits belong to the owner**

All the profits earned by a sole proprietorship is enjoyed solely by the owner.

- ★ **Privacy of the business information is secured**

Since all the management and administrative activities of a sole proprietorship are usually done by its owner, it is less likely that the business information be transmitted to external parties.

- ★ **Ability to use own skills at the best**

Since all benefits accrue to himself, the owner renders his skills and dedication at his best to achieve the growth of the business.

- ★ **Independent decision making**

The owner can take decisions quickly, since all the decisions regarding the business are taken by its owner himself.

Disadvantages of sole proprietorship

Sole proprietorships have following main disadvantages compared to other business organizations.

- ★ **Unlimited liability of the owner**

The owner is personally liable for all the debts of the business. If the level of debt is higher than the value of all the assets of the business, the owner must sacrifice even his private properties to pay off debts.

- ★ **Difficulties in raising capital**

The financial strength of an individual is limited. In addition, it is difficult to raise capital from external parties such as banks, due to the higher level of risk involved in sole proprietorships and due to the unlimited liability of its owner.

- ★ **No continuous existence**

The business operations of a sole proprietorship could be discontinued due to the death of its owner or owner being mentally incapable.

- ★ **No legal personality**

A sole proprietorship does not have a legal personality. Therefore, all the legal activities of the business have to be conducted under the personal name of its owner.

- ★ **Individual decisions of the owner can be unsuccessful**

There is a possibility that the individual decisions taken based only on the knowledge and experience of an individual can become unsuccessful compared to collective decisions.

Partnerships

The relationship among individuals conducting a business in common with an objective to earn a profit is known as a partnership. The Partnership Ordinance of 1890 affects partnerships. Professions such as accountants, lawyers, tax officers and doctors may also conduct their practice as a partnership.

Example:

A set of chartered accountants carrying out an audit firm.



Figure 3.7

Characteristics of partnerships

The following special characteristics can be seen in partnerships compared to other business organisations.

- ★ **Number of members in a partnership**

There should be 2 members minimum and according to the Companies Act No. 07 of 2007, a maximum of 20 members to commence a partnership.

- ★ **Partnership Agreement**

A partnership commences with an agreement among its partners, which is known as the **partnership agreement**. This agreement can be in written, orally or implied. According to the Prevention of Fraud Ordinance if the initial capital of the partnership is greater than Rs. 1000, a partnership is required to be conducted under a written agreement. This written agreement is known as **partnership deed**.

- ★ **Unlimited liability of partners**

Partners are unlimitedly liable for the debts of a partnership. If the assets of the business are not sufficient to pay off its debts, partners are liable to sacrifice their private properties even to pay off debts.

- ★ **Not mandatory to register a partnership**

If a partnership is conducted under the full names of all the partners, it is not required to register. However, if a partnership is conducted under a different name, the business name should be registered. Registrar of the respective Provincial Council is the authorized officer to register business names.

- ★ **No separate legal identity**

A partnership is not considered as a legal person in front of law. Therefore, a partnership is unable to perform any legal activities in its business name. Partners are required to use their personal names in legal matters.

- ★ **No continued existence**

The existence of a partnership will be ceased due to the death of a partner or a partner being mentally unstable.

Advantages of partnership businesses

The partnership have following advantages compared to other business organizations.

- ★ **Convenient to commence**

Partnership businesses are also easy to commence like sole proprietorships. The legal regulations pertaining to the commencement and conduct of partnerships are comparatively low.

- ★ **Can raise more capital**

Since a partnership consists of two or more members, they can raise more capital compared to a sole proprietorship.

- ★ **Can utilize different skills of partners**

As various individuals involve in a partnership, special skills of them can be utilized.

- ★ **Shared liability among partners**

The liabilities arising from operations of a partnership will be shared among all the partners in the business.

- ★ **Can take collective decisions**

More accurate decisions can be taken in a partnership by considering the views of all the partners collectively.

Disadvantages of partnership businesses

- ★ **Unlimited liability**

Partners in a partnership are also unlimitedly liable regarding the debts of the business. Therefore, when the debts of the business are more than the capital partners have provided, they are liable to sacrifice their personal properties to pay off that debt.

- ★ **Profit shared among partners**

Even though the owner of a sole proprietorship enjoys all the profits earned, in a partnership, the profits earned are shared among the partners.

- ★ **Conflicts among partners**

Conflicts could arise among the partners of a partnership due to certain decisions taken when conducting the business. These conflicts will cause a business to become a failure.

- ★ **No continued existence**

A partnership may be dissolved due to the death of a partner or a partner being mentally instable.

- ★ **No legal personality**

Since a partnership is not accepted as a legal person in front of law, the partners are required to use their own personal names in all legal activities of the partnership.

Incorporated companies

A firm which is required to be registered under the Companies Act No. 07 of 2007, with a legal personality, can raise capital by issuing shares and the liability of the shareholders being limited, is an incorporated company. The owners of these companies are the shareholders. Their liability is limited to the amount they have paid or liable to pay for the shares they have purchased.

Characteristics of incorporated companies

The following are some major characteristics that are common in incorporated companies.

- ✦ **Incorporation under the Companies Act**

In order to commence an incorporated company, it is required to be incorporated under the Companies Act No. 07 of 2007. As per the provisions in the Act, the duly completed relevant documents should be submitted to the Registrar of Companies.

- ✦ **Continued existence**

Since a company is considered as a separate legal entity from its owners, the death of shareholders or shareholders being bankrupt shall not affect to the continued existence of its business activities.

- ✦ **Ability to register with limited liability**

Shareholders have a limited liability with regard to the debt and other liabilities of a company. The liability of shareholders is limited to the value of the shares they have purchased. Hence, they are not required to sacrifice their private properties unlike in sole proprietorships and partnerships.

- ✦ **Can raise capital by issuing shares**

An incorporated company can raise capital by issuing shares.

Advantages of incorporated companies

The following advantages can be seen in incorporated companies compared to other business organizations.

- ✦ **Can raise more capital**

A higher level of capital can be raised by issuing shares. Due to the higher recognition of the incorporated companies, it is easy to raise funds by obtaining loans from external parties as well.

- ✦ **Receiving legal personality**

A company is considered as a legal person in the presence of law. Therefore, a company can enter into contracts, can appoint agents, can acquire assets and can pay taxes etc. in its name.

- ✦ **Continued existence**

The continued existence of a company will not be disrupted by the death of its shareholders or due to bankruptcy. Therefore, a company can conduct their operations continuously.

- ✦ **Limited liability**

The liability of shareholders of an incorporated company are limited to the amount of capital they have invested in the company.

- ✦ **Managed by a Board of Directors**

The business activities of a company are managed by a Board of Directors selected and appointed by the shareholders of a company.

Disadvantages of incorporated companies

The following are some of the disadvantages that can be seen in limited companies compared to other business organizations.

- ✦ **Greater level of legal provisions**

Since the legal provisions relevant for starting a company, conducting operations and winding up of a company are comparatively higher, conducting a limited company is more complex compared to other forms of business organizations.

- ✦ **Profits and ownership are shared**

In the case of an incorporated company that has a large number of shareholders, the ownership and profits are shared among them.

Cooperative Societies

A cooperative society is a democratically controlled independent organization. Further, it aims to achieve common needs of a group of individuals voluntarily gathered and enjoy a collective ownership. A cooperative society can be started with at least ten members and the capital is mainly provided by the membership subscriptions. In addition, cooperative societies are required to be registered under the Cooperative Societies Act No. 05 of 1972.

Examples :-

Sri Lanka Multi Purpose Cooperative Societies

Sri Lanka Coconut Producers' Cooperative Society

Thrift and Credit Cooperative Societies (SANASA)

Characteristics of cooperative societies

The following are some unique characteristics of cooperative societies.

- ★ **Democratic control**
The democratic control is that the cooperative society will be controlled by a Board of Directors elected by its members and the decisions are taken based on the consent of the majority.
- ★ **Voluntary and open membership**
Any individual can obtain membership and any member can withdraw from the membership voluntarily.
- ★ **Collective ownership of members**
A cooperative society is owned by its members and all its assets are also owned by all the members.
- ★ **Common expectations and needs**
The main objective of a cooperative society is to achieve the well being of its members and facilitate development of society.

Advantages of cooperative societies

The following advantages can be seen in cooperative societies compared to other business organizations.

- ★ **Democratic control**
Board of Directors can be elected and decisions will be taken based on the consent of the majority of members.
- ★ **Acting for the well being of members**
Since cooperative societies are established with common goals, it will carry out its operations emphasizing the social responsibility and equity to all.
- ★ **Government provides various incentives for conducting cooperative societies**
- ★ **Shared economic benefits**
Excess profit earned through the business activities of a cooperative society will be distributed among the members in different forms.

Disadvantages of cooperative societies

- ★ **Limited capital**
Since the capital is raised only by the membership subscriptions of members, the amount of capital that can be collected is limited.
- ★ **Should adhere only to the stipulated cooperative policies**
This type of business organizations are based on cooperative policies. It is not possible to change the business operations in order to face competitive business environment, since it is required to adhere to these policies.

Associations

Associations are organizations with the objective of social well-being. These associations are established especially in order to achieve well-being of the members, to accomplish a community service or a charitable activity.

Examples :-

- Sports Clubs
- Farmer's Associations

State corporations

Businesses fully owned or the majority is owned by the government are known as state corporations. A state corporation is controlled by a Board of Directors appointed by the government. These businesses will be commenced under a general or special act of the Parliament. These are also known as state corporations, commissions, authorities, boards and bureaus.

Examples :-

1. Sri Lanka Rupavahini Corporation
2. Sri Lanka Ports Authority
3. Coconut Development Authority
4. State Pharmaceuticals Corporation of Sri Lanka
5. Sri Lanka Bureau of Foreign Employment
6. Export Insurance Board

Characteristics of state corporations

The following characteristics can be seen in state corporations compared to other business organizations.

- ★ **Government ownership and control**
The full or majority of ownership and control is vested with the government. In some instances, the private sector also hold a minority of shares.
- ★ **Objective of providing services in common**
Most of the state corporations are aimed at providing services in common to the general public.
- ★ **Legal personality**
In legal activities, a state corporation has a separate legal identity.
- ★ **Can commence either under a special act or a general existing act**
- ★ **Continued existence**
Since state corporations are established under an act of Parliament, they have a continued existence.

Advantages of state corporations

- ★ **Appropriate for the provision of essential services**
State corporations are suitable to provide essential services, which may not be provided by the private sector to the general public.
- ★ **To reduce the monopoly effects of private sector**
State corporations can be used to create a competitive environment to reduce unfavorable influences arising through private sector monopolies.

Example :-

Sri Lanka Transport Board

- ★ **Profits owned by the public**
A portion of the profits earned by a state corporation will be credited to the Consolidated Fund of the government.

Disadvantages of state corporations

- ★ Absence of independence in decision making
- ★ Need to adhere to financial regulations of the government

Departments

The state departments are institutions that will be directly and fully governed by the government under a ministry. Departments are operated in order to provide various services to the general public.

Examples :-

Sri Lanka Railway Department

Sri Lanka Postal Department

Characteristics of state departments

The following characteristics can be seen in state departments compared to other business organizations.

- ★ **Ownership and control vested with the government**
Departments are fully owned by the government and directly governed by the Parliament and the respective ministry. The management and administration is done through the Heads of departments.
- ★ **In legal activities, the head of the department should represent the department using his designation.**
- ★ **Continued existence**
The existence of a department depends on the discretion of the government.
- ★ **Funded by the government**
The required funds will be allocated by the annual budget of the government.

Advantages of state departments

- ★ The departments provide essential services to the public that will not be otherwise provided by the private sector.

- * The departments will handle long term development activities which require a larger amount of funds.
- * A large number of employees are working in departments providing more employment opportunities.
- * The departments provide services for the well being of the general public without a profit motive.

Disadvantages of departments

- * The decision making will be delayed due to the approval required from the Parliament and the respective ministry.
- * The departments have to conduct activities in accordance with the provisions in government Financial Regulations, Establishment Code and different circulars.

3.2 Selecting an appropriate business organization

The different types of business organizations that can be organised to fulfill the needs and wants of humans are discussed previously in this chapter. The following are some factors that should be considered by businessmen when selecting an appropriate type of business organization.

- * Based on the objective
- * Based on the scale
- * Based on who will perform management activities

Selecting a business organisation based on the objective

There are two main objectives affecting the choice of a business organisation.

- * Profit objective
- * Social welfare objective

Profit objective

Most of the businessmen expect to earn a profit in doing business activities. The maximization of profits is the objective of these businessmen. The previously mentioned sole proprietorships, partnerships, incorporated companies and state companies are generally established with a motive to earn profits.

Social welfare objective

There are business organizations that operate to fulfil human needs and wants while concerning the well-being of the society. These organizations have objectives such as facilitating well-being of the members and providing relief services for the people facing disasters and unrest. These businesses operate both in the private and public sectors.

Examples :-

Farmers' Associations, Sports Clubs etc
Cooperative Societies
State departments

Selecting a business organization based on the scale

It is required to consider the scale of a business when selecting a type of business organization. Determining the scale of a business depends on several factors. The financial strength, skills and experiences and various relationships of the owner are some of the major factors. In addition, the quantity of goods and services produced by the business, market share of the respective product will also be considered when deciding the scale of the business. Accordingly, there are two major types of businesses that can be identified based on the scale.

- * Small scale businesses
- * Large scale businesses

Small scale businesses

Businesses are generally started as small scale businesses. Most of the small scale businesses are sole proprietorships. The ease of starting with less capital, with less legal influences are some reasons for selecting sole proprietorships.

Large scale businesses

A large scale business can be commenced with a large pool of resources owned by the businessman, experiences obtained by working in other businesses, network of relationships that stimulate businesses and with the infrastructure facilities and other incentives provided by the government.

Selecting a business organization depending on who will perform management activities

Management is a process of planning, organising, leading and controlling the resources of a business in order to achieve the objectives of a business.

A sole proprietorship will be managed by its owner. He can take all the decisions of the business independently. In addition, he will be the owner, leader as well as the manager of the business. As the owner, he has the freedom to take decisions regarding the sources of a business.

If a business is expected to be managed by a group of individuals, a partnership or an incorporated company type of business organization would be the appropriate type. Here, decisions can be taken with the consent of all partners or the directors of the board.

3.3 Registration of a sole proprietorship

If a sole proprietorship is conducting in a different name other than the full name of its owner, it is mandatory to register the name of the business.

Example :-

If Gayal Perera conducts his business under the name of 'Gayal Stores', the business name is required to be registered.

This is only a registration of the business name and hence will not provide a legal personality for the business.

Legal procedure of registering a sole proprietorship

If a sole proprietorship is conducted in a name other than the full name of its owner, it is required to register. Registrar of the respective Provincial Council is the authorized officer to register business names. The application form required for the registration can be collected from the office of the Divisional Secretariat. The registration fee will be determined by the respective Provincial Council within the authority given to them. Further, it is required to submit an application to register the business name within 14 days of commencing a sole proprietorship.

The following procedure will be followed when registering a sole proprietorship.

01. Obtain the relevant application form from the respective Divisional Secretariat office.

The following two documents are required to submit for this purpose.

- i An application form to register the business name of a sole proprietorship.
 - ii An application form to obtain the required report from Grama Niladharee regarding the registration of the business name.
02. Handing over the certified report of the Grama Niladharee and the duly completed application form along with the registration fee to the Divisional Secretary.
03. After considering above documents, the Divisional Secretary will issue the Certificate of Registration of Business Name. It is required to display this certificate at the business place.

Advantages of registering the business name

The following advantages can be achieved by registering the business name of a sole proprietorship.

★ Provides an identity and recognition

A business can be separately identified from other businesses by using the business name.

★ Provides an ownership of the business name

Since the business name is registered under the name of the owner, this ensures the ownership of the business name.

★ Provides a qualification to obtain incentives given by the government

The government provides various incentives for the businesses. The registered businesses will be given the priority when giving such facilities.

*** Easy to obtain loans**

Since there is a higher trust on businesses that have registered their business names, lenders prefer to supply loans to such businesses.

 **Activity 01**

Consider a sole proprietorship that can be commenced utilising the resources available in your area.

01. Suggest a suitable name for the business.
02. Explain the advantages of commencing a sole proprietorship.
03. Can there be disadvantages of commencing such a business as a sole proprietorship? Justify your answer.
04. Is the business name of that sole proprietorship required to be registered? Justify your answer.
05. If the name of the business needs to be registered, explain the procedure that needs to be followed.

 **Activity 02**

Prepare a table by listing similarities and differences among business organizations under the below mentioned dimensions.

Dimension	Sole proprietorship	Partnership	Limited companies	State corporations	State department
Ownership					
Financing					
Liability					
Management					
Legal Personality					
Continually					

 **Activity 03**

The following are the names of businesses.

- j Nandu Company Limited
- j Janahitha Stores
- j Silva and Sons
- j Cooperative Society of Fisheries
- j Young Buddhists Association
- j Sri Lanka Railway Department
- j Sri Lanka Broadcasting Corporation

01. Name type of business organization of each business mentioned above.
02. Classify the above business based on the ownership.
03. Classify the business based on the objective.
04. From the above businesses, which businesses have a legal personality?
05. State how each business raise the required capital



Activity 04

Pahan prefers to take collective decisions by listening to all and prefers to share the risk. He believes in group work and has the ability to act with others with a mutual understanding and even would accept a responsibility of a friend. However, Pahan has a limited amount of savings.

Dinuka prefers to take individual decisions and could face any risk alone. He is always dedicated to be successful in every thing he does. Pahan owns a large amount of savings.

Pahan and Dinuka both expects to start a business

01. Suggest the appropriate types of business organization for Pahan and Dinuka. Give reasons.
02. If Pahan and Dinuka Start those businesses, what are the advantages and disadvantages that they will receive?