

## *Chapter 06*

# *Business Organizations*

This chapter discusses the followings.

- 6.1 Introduction to business organizations
- 6.2 Classification of business organizations
- 6.3 Sole proprietorships
- 6.4 Partnerships
- 6.5 Incorporated companies



## 6.1 Introduction to business organizations

You have already gained a good understanding about the preparation of business plans. The next step is selecting a suitable type of business organization in order to implement the plan. This chapter aims to give you the required guidance with this regard. At present different businesses help people to satisfy their needs and wants. Accordingly, businesses are related with all daily activities of people. The influence of businesses can be seen not only when we fulfill our daily requirements like foods and cloths, but also when satisfying our all other day today needs and wants.

### *Example :-*

Products like books, pens and pencils that you use

Different organizations that provide the services like banking and insurance



### *Activity 01*

Name some of the day to day wants of your home and state the business organizations that help to satisfy them.

No.	Want	Business organization
01.		
02.		
03.		
04.		
05.		

After doing the above activity, you can understand that it is necessary to get the assistance of different parties in order to fulfill your needs and wants and you are clear that business organizations are behind all these activities. To start and run businesses, individuals should organize as groups. Thus, units comprise of group of people working together for the purpose of achieving a common goal are called organizations. Accordingly, different business organizations have been established at present in order to satisfy the needs and wants of people.

Entities that engage in production and distribution of goods and services with the aim of earning profits, achieving social wellbeing or fulfilling any other objective while using limited resources to satisfy human needs and wants are called business organizations.

Some of the common characteristics that can be seen in every business organization are given below.

- ✦ Having an objective
- ✦ Using limited resources
- ✦ Having an organizational structure
- ✦ Engaging in an economic activity
- ✦ Having a group of people who work together (owners, employees etc.)

## 6.2 Classification of business organizations

Today different business organizations have been established to supply goods and services for the purpose of satisfying needs and wants of people.

These different types of business organizations can be classified based on different criteria. Here, we consider only the following criteria which are often used.

- ✦ Ownership
- ✦ Objective

### **Classification of business organizations based on ownership**

The ownership of the business is explained based on the way the financial resources are provided to start the business. Parties that deploy resources in the business are called owners. Owners enjoy the profits or losses earned by a business.

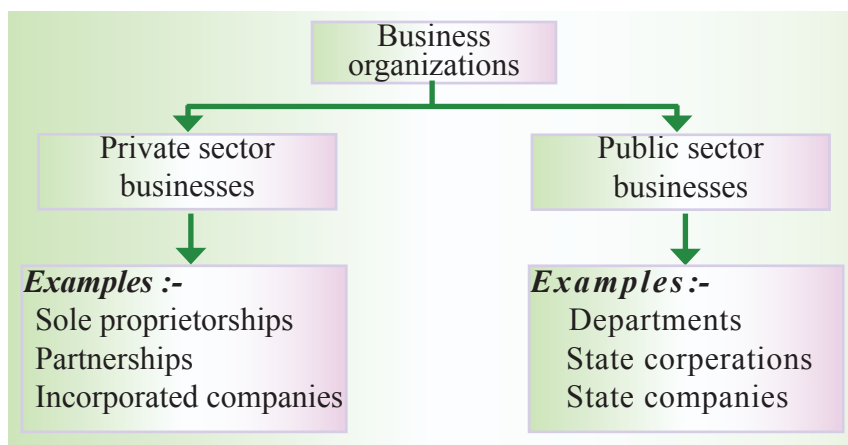
**Based on ownership, business organizations are classified as follows.**

- ✦ Private sector businesses
- ✦ Public sector businesses

When financial resources are deployed in a business by an individual or group of individuals, the ownership of the business is with the private sector. Then they are called private sector businesses.

Similarly when the financial resources are provided by the government, the ownership is with the government and they are called public sector organizations.

Classification of businesses based on the ownership is given below.



*Figure 6.1: Classification of businesses based on ownership*

## Classification of business organizations based on their objectives

Entrepreneurs conduct businesses with the aim of achieving different objectives. Businesses can be classified as follows based on their objectives

- ✚ Profit oriented businesses
- ✚ Not-for profit organizations

If a business is carried out by an entrepreneur with the objective of gaining profit, such businesses are called profit oriented business organizations.

### ***Examples :-***

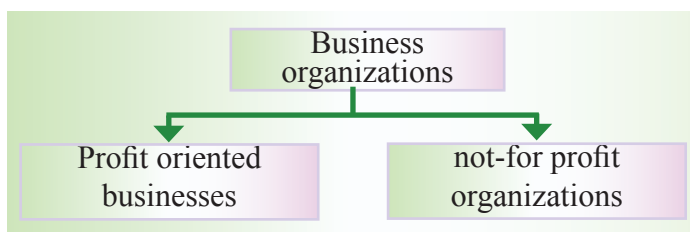
- Private hospitals
- Private Banks
- Super markets
- Garment firms

Similarly, the objective of some businesses is not to earn profits but to provide benefits to the society. Such organizations are called not-for profit organizations.

**Examples :-**

Red Cross  
Lions club  
Sarvodaya  
Sports clubs

Profit oriented businesses and not-for profit organizations are operating under both the private and the public sectors. Figure 6.2 depicts how the business organizations are classified based on the objective.



*Figure 6.2: Classification of businesses based on the objective*



**Activity 02**

State few organizations from which you fulfill your daily needs and fill the following table relating to those organizations.

No.	Organization	Objective	Ownership
01	Super market	Profit	Private
02			
03			
04			
05			

After learning the above information, we hope that you have understood that businesses can be classified based on different criteria. An entrepreneur should be clever enough to select the most suitable type of business organization among these different types of business organization.

We discuss only the following types of business organizations which are classified based on ownership.

- P Sole proprietorships
- P Partnerships
- P Incorporated companies

## 6.3 Sole proprietorships

At present sole proprietorships can be identified as one of the most common business types that many entrepreneurs start. These are also known as single owner businesses. Since entrepreneurs can easily start these businesses with a small amount of capital, they can be seen in almost all the countries in the world.



*Figure 6.3*

A business started, owned and run solely by the owner is known as a sole proprietorship.

### **Main characteristics of sole proprietorship.**

Some of the main characteristics of sole proprietorships are given below.

- P Capital is provided by the owner

An initial capital is required to get the different resources that are required to start the business. Investing the capital solely by the owner is a characteristic of sole proprietorships. Capital can be found through different ways including owners' savings, funds given by relatives or friends, a loan obtained by selling or mortgaging his/ her assets or a loan taken from a financial institution.

❖ Ownership rests with a single person

Since capital required for the business is invested by a single person, the ownership too is with that person.

❖ Profits or losses are borne alone

The profit earned by the business belongs to the owner. Similarly, if the business incurs losses, that should be borne by the owner alone.

❖ No continued existence

The continuity of the business can stop due to such reasons as death of the entrepreneur, insanity or any other passivity.

❖ Unlimited liability of the owner

Liability means the obligations to repay the loans and other advances obtained from external parties. In sole proprietorships, liability of the owner is unlimited. This means that even the private properties of the entrepreneur may have to be sacrificed to settle the liabilities of the business.

❖ Registration is not mandatory

It is not mandatory to register a sole proprietorship. Yet registration of the business is very useful. If it is registered, it will be registration of the business name. Here the name of the business will be registered. The business name will be registered under the Business Name Registration Ordinance, No.06 of 1918 at the divisional secretariat of the respective provincial council.

❖ No legal personality

This means that a sole proprietorship cannot conduct any legal operations by its own business name. If required to do so, it should be done by the personal name of the owner.

***Examples :-***

Filing legal cases, obtaining bank loans, purchasing of vehicles should be done not by the name of the business but by the name of the owner.

- P Business can solely be led at owner's discretion

**Examples :-**

Hiring and firing of employees  
Expanding the business operations  
Making decisions regarding the price of the products

## **Starting Sole Proprietorships**

Though starting a sole proprietorship is easy, there are few steps which should be followed practically by an entrepreneur. They are given below.

- P Obtaining the following applications from the Divisional Secretariat from the respective division where the business is expected to be started.
  1. An application form to register the business name of a sole proprietorship
  2. An application form to obtain the required report from Grama Niladharee regarding the registration of the business name
- P Handing over the certified report of the Grama Niladharee and the duly completed application form along with the registration fee to the Divisional Secretary.

After receiving the above documents along with the due payments, Divisional Secretary will consider them, and if satisfied will register the business and issue the **Certificate of Registration of Business Name**.



### **Activity 03**

Obtain the forms required to start a sole proprietorship.

01. Observe the facts which have been requested in these forms.
02. Discuss with your friends and gather the data required to fill these forms.

## **Advantages of sole proprietorships**

- P Can be started with a small amount of capital
- P Can get the assistance of the members of the family
- P Convenience of starting
- P Can make independent decisions



- P Ability to improve the business with the dedication and the enthusiasm of the entrepreneur
- P All the profits belong to the owner
- P Privacy of the business information is secured
- P Impact of rules and regulations is minimal

### Limitations of sole proprietorships

- P Sources to get the required capital are limited
- P No separate legal identity
- P Unlimited liability of the owner
- P No continuous existence
- P Losses should be solely borne by the owner
- P Individual decisions of the owner may be unsuccessful



#### Activity 04

*Saman started a business enterprise using a small amount of money he had saved. He was happy as he didn't have to make much effort and spend much time for the initial activities in the establishment of the business. He was committed to the business and worked hard.*

*Though different difficulties arose, he gave quick solutions to them converting the issues in to his experiences and conducted the business activities continuously. Once Saman had to appear before the courts as a customer filed a case against one of his employees for a mistake done by the employee. However, Saman was able to continue with his plans and run the business profitably.*

*Though Saman wanted to improve his business further, he realized that obtaining the required additional capital is difficult. Even though there was the possibility of obtaining bank loans further, he was not interested to do so since there was the risk of settling them.*

*Though Saman got sick due to the heavy work load of the business, he always tried his best to carry on the business activities successfully.*

01. To which category does the above business belongs to?

02. Give benefits and limitations of that type of business organization.

## 6.4 Partnerships

Partnerships too have received an important place in the economy as a type of a private sector business organization. The ability of entrepreneurs to engage in business activities together than individually has been a major reason for the establishment of partnerships. Similarly partnerships have emerged owing to the requirements of getting more capital, making right management decisions, getting the involvement of individuals with different skills, etc. It can be seen that people who are engaged in the professional fields such as accounting, law, tax and medicine and the parties who do production and trade organize as partnerships.

Partnership Ordinance of 1980 affects the partnerships conducted in Sri Lanka. According to this Ordinance, partnerships are defined as follows.

**A relationship between two or more individuals with the objective of earning profits is known as a partnership.**



*Figure 6.4*

### Main characteristics of partnerships

Special characteristics of a partnership are given bellow.

❖ Number of partners

In order to start a partnership there should be minimum of two partners and the maximum number is limited to 20.

❖ Existence of an agreed (stipulated) relationship among partners

A partnership is started according to the agreement arrived by the partners. This agreement can be written, oral or implied. The agreement among the partners regarding the partnership is known as the partnership agreement.

❖ No continued existence

The continuity of the partnership is obstructed due to the change of the partnership agreement or the death, insanity or bankruptcy of a partner.

### ❖ Unlimited liability of the partners

Partners are unlimitedly liable for the liabilities of the partnership. Accordingly, partners may have to sacrifice their private properties to pay off the debt of the partnership if the assets of the partnership are not sufficient when settling its liabilities.

### ❖ No separate legal identity

Since a partnership is not considered as a legal person before the law, it cannot perform legal activities in its business name. Hence, the legal matters of the partnership should be done not in its business name but using the personal names of the partners.

### ❖ Not mandatory to register a partnership

It is not mandatory to register a partnership. Yet many advantages can be obtained by registering a partnership. Here the business name of the partnership will be registered. Registration can be done under the Business Name Registration Ordinance, No 06 of 1918 at the Divisional Secretariat of the respective provincial council.

### ❖ Every partner will be a representative (or an agent) of other partners

Every partner is liable for the affairs done by each partner. Hence, every partner is considered as a representative of other partners.

## Starting a partnership

A partnership can be started in the same way as a sole proprietorship. Yet, since there may be a maximum up to 20 partners, it might face different practical issues when running the business. Though a partnership agreement can be arrived at in writing, orally or by implication (implied), it is more suitable to conduct the partnership on a written agreement.



*Figure 6.5*

This written agreement is known as the **partnership deed**.

It is important to have the stipulated agreement in writing in order to minimize the practical issues that may arise in a partnership when doing business.

**Some of the factors included in a partnership agreement are given below.**

- P The method of capital contribution by the partners
- P The way of sharing profits and losses
- P The way how the partners contribute to the affairs of the business
- P Paying salaries to the partners
- P Obligations and rights of partners
- P Information relating to ceasing / dissolving the partnership
- P Arrangement of paying interest to the partners for the loans given to the business other than the capital
- P Other common agreements regarding the conduct of the partnership

### **Advantages of partnerships**

- P Convenience of commencing
- P Can raise more capital
- P Can take collective decisions
- P Liabilities are shared among the partners
- P Can utilize different skills of the partners

### **Limitations of partnerships**

- P Unlimited liability
- P No separate legal identity
- P Possibility of arising conflicts among partners
- P Profits being shared among partners
- P No continued existence
- P Consequences of a mistake done by a partner can affect other partners



### Activity 05

*Amal Piyrathne and Kamal Jayarathne started a partnership to sell garments and agreed to register it under the name of “Rathna Dress”. Further they agreed to put Rs 50,000 by each and to equally share the profits and losses of the business. Kamal decided not to engage in business activities since he was doing another job and it was agreed that Amal should attend to the marketing affairs of the business for a monthly salary of Rs. 20,000. Moreover, they decided to pay an annual interest of 10% for the extra funds invested in the business other than the capital. Similarly they decided that in case if a new partner joins the business, it should be done with the consent of both partners.*

Prepare a partnership deed for the partnership, “Rathna Dress” according to the above information.

## 6.5 Incorporated companies

Incorporated companies can be identified as a popular form of business organization which mainly represents the private sector category. Companies Act No. 07 of 2007 of Sri Lanka affects the commencement of an incorporated company.

Since even a single person can start an incorporated company according to the Companies Act of Sri Lanka, most of the entrepreneurs are interested in starting this type of businesses. Receiving the status of a legal personality is another reason for the popularity of incorporated companies.

An incorporated company can simply be defined as follows.

**Incorporated companies are business organizations which are registered under the Companies Act No. 07 of 2007 and which have a separate legal identity and a continued existence.**

### Characteristics of incorporated companies

Some of the basic characteristics of incorporated companies are given below.

## P Incorporated under the Companies Act

Every company should be registered under the Companies Act No. 07 of 2007. It is done by the Registrar of Companies of the Department of Registrar of Companies.

## P Raising capital through shareholders

The capital required for an incorporated company is raised by issuing shares.

## P Limited liability of the shareholders

In an incorporated company, the liability of the shareholders regarding liabilities is limited. This means that the liability of the shareholders is limited to the value of the shares they had bought from the company.

## P Management of the company is done by directors

The management of a company is done by directors selected and appointed by the company shareholders who are the owners of the company too.

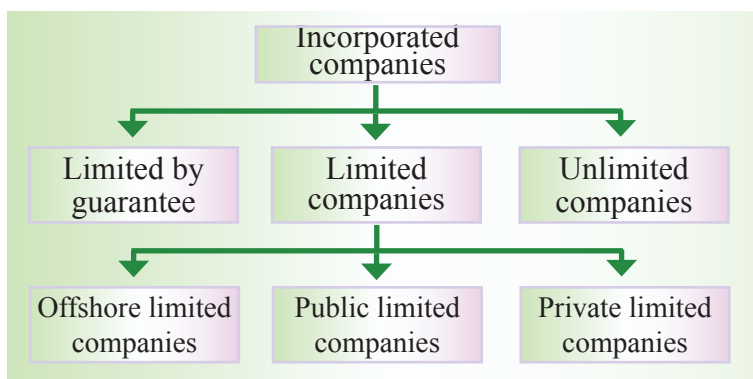
## P Having a continued existence

An incorporated company is a separate entity from its owners. Hence the death, bankruptcy or full or half passivity of a shareholder does not obstruct the continuation of the company.

## P Have a separate legal personality

Companies are incorporated under the Companies Act No 07 of 2007. Hence, an incorporated company is considered as a legal person and entering in to contracts, acquiring assets, obtaining loans from financial institutions etc., can be done in the name of the company.

Types of companies which can be started according to the Companies Act No 07 of 2007 are given below in the figure 6.6.



*Figure 6.6 Types of companies*

According to the Companies Act, different types of companies can be started. Only private limited companies are discussed here. Most of the small and medium sized entrepreneurs prefer private limited companies for their businesses.

## **Private limited companies**

Private limited companies can be identified as a business organization which is popular among the Sri Lankan entrepreneurs at present. Ability of even a single person to start, having a legal personality, ability to get the involvement of family members, friends and relatives, etc., for the commencement are the main reasons for this popularity.

Companies Act of No. 07 of 2007 has given a definition to private limited companies and it can be stated as follows.

Companies of which the number of shareholders are limited to 50, shares cannot be offered to the public and, liability is limited are known as private limited companies.



## Activity 06

List private limited companies that operate in each of the following fields in Sri Lanka.

No.	Field	Private companies
01.	Tourism	
02.	Education	
03.	Trade	
04.	Manufacturing	
05.	Agriculture	
06.	Construction	

### Starting a private limited company

To conduct a private limited company, it should be registered under the Companies Act No 07 of 2007. For the registration, following four documents should be submitted to the Registrar of Companies.

#### 01. Statement regarding the name of the company

Companies Act of No.07 of 2007 includes provisions that should be followed when selecting a name for a limited company.

#### **Examples :-**

A name that is identical or similar to a name currently in use should not be used as the name of the company

Words like Sri Lanka, State, and President should not be used in the company's name

#### 02. Articles of Association

The statement which includes information relating to the general administration of a limited company. According to the Companies Act of No. 07 of 2007. Following information are included in the Articles of Association.



The objectives of the company  
The rights and obligations of shareholders of the company  
The information relating to management and administration of the company

03. The statement specifying the consent of each of the initial director to act as directors of the company
04. The statement specifying the consent of the initial secretary to act as the secretary of the company

If the Registrar of the Companies is satisfied with the documents submitted, the company will be registered under the Companies Act of No 07 of 2007. After the registration, the Registrar will issue the **Certificate of Incorporation**.

### **Characteristics of a private limited company**

Some of the main characteristics of private limited companies are given below.

❖ Cannot invite the general public to purchase the shares of the company

Buying the shares of a private limited company could be done only by the members of the family, friends and relatives. Shares of these companies cannot be offered to the public.

❖ Minimum number of shareholders is one and maximum is 50

Since, based on the companies Act, even a single person can start a private limited company, the minimum number of shareholders of a private limited company will be one. Similarly, the maximum number of shareholders of such companies has been limited to 50 by the Companies Act.

❖ Managed by a board of directors

Management of limited companies is done by a board of directors. According to Companies Act, there should be at least one director in a limited company to manage the company affairs. Yet the Companies Act does not specify the maximum number of directors.

❖ Has a legal personality

❖ Has a continued existence

P Accounting and auditing is mandatory

P Liability is limited

### **Advantages of private limited companies**

- P Even a single person can commence
- P Since the ownership of the company is with few people, controlling is easy
- P The profits of the company is shared among few
- P Can commence by getting the involvement of the family members, friends and relatives.
- P Being formal and having a high recognition
- P Limited liability
- P Having a separate legal identity
- P Having a continued existence

### **Limitations of private limited companies**

- P Inability to raise more capital since the shares are issued to the members of the family, friends and relatives
- P Having mandatory rules, regulations and procedures
- P Opportunity to get the involvement of many people is limited since the maximum number of shareholders is limited to 50

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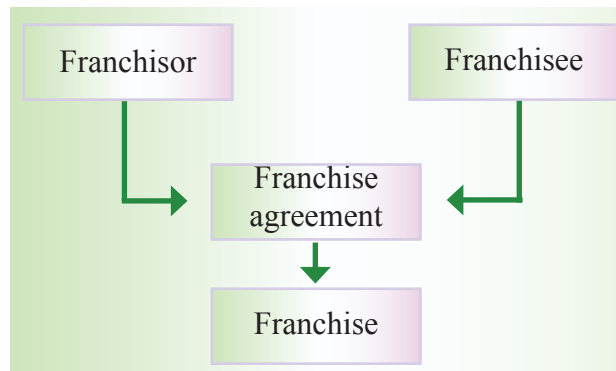
## **Franchises**

Franchises can be identified as a business concept which has emerged to face the rapidly changing business environment. This gives the opportunity to an entrepreneur to join the large scale businesses and carry on the business activities. These businesses are operated as sole proprietorships, partnerships or incorporated companies.

A form of business organization to which the power is granted by an existing business which sells a product or service, to sell the said product or service in a specific market area under its trade name are known as franchises.

## Starting a franchise

At present, franchises are operating under different forms. However, the basic structure of any franchise is given below.



*Figure 6.7: starting a franchise*

**There are two main parties who are involved in a franchise.**

### ❖ Franchisor

The party that allows to sell its products in a specific market area under his/her name. The objective of this party is to expand the market without investing capital and to earn profits.

### ❖ Franchisee

The party that gets the permission to sell goods or services in a specific market area using the brand name of the franchisor.

In order to enter in to this type of a business relationship, the franchisor and the franchisee should enter in to a stipulated (agreed) relationship. This is known as franchise agreement. Common agreements regarding the commencement and the conduct of the franchise are given in the franchise agreement.

Examples for some such common agreements are given below.

***Examples :-***

Services provided by the franchisor to franchisee

Products that are being allowed to sell

The value of the payment made by the franchisee to franchisor

As the result of the franchise agreement entered in to by the franchisor and the franchisee, franchises are formed. Depending on the permission granted by the franchisor to sell the products and services in his/her name to the franchisee, charges have to be made. This charge is known as royalty.

**Basic characteristics of a franchise**

Following basic characteristics can be seen in franchises.

❖ Involvement of two parties as franchisor and franchisee

Franchisor grants the permission to sell the products and services in a specific market area in his/ her trade name. Based on the permission granted, franchisee sells the products and the services in a specific market areas under the relevant trade name. Accordingly, two parties as franchisor and franchisee are involved in a franchise.

❖ There is a stipulated agreement between the franchisor and the franchisee.

Franchises are formed depending on the agreement entered in to by the franchisor and franchisee. This written agreement is known as the franchise agreement.

❖ Franchisee makes a payment to the franchisor.

Franchisor allows the franchisee to sell the products and services in the name of franchisor for a payment. Details regarding this should be included in the franchise agreement.

**Advantages of franchises**

There are few benefits that both the franchisor and the franchisee can obtain in common due to franchises.

## **Benefits to the franchisor**

- ❖ Opportunity to expand the business activities to other markets without his/her own investment.
- ❖ Ability to enjoy large scale benefits by minimizing the pressure of maintaining a huge staff.
- ❖ Franchisor receives an income

## **Benefits to the franchisee**

- ❖ Franchisee gets an opportunity to earn profits using the goodwill of the franchisor
- ❖ Franchisee can easily enter to a popular market using the goodwill of the franchisor
- ❖ Franchisor provides management training to franchisee.

## **Limitations of franchises**

### **To the franchisor**

- ❖ Due to the unsuccessful business dealings of the franchisee, the goodwill of the franchisor can be damaged
- ❖ Franchisor has to obey the legal bonds and the limitations that arise when conducting the business activities of a franchise

### **To the franchisee**

- ❖ Franchisee has to incur the legal charges, bank charges, establishment cost etc. to get the franchise
- ❖ Franchisee cannot work independently due to the control of franchisor
- ❖ Franchisee may have to pay a high royalty and other charges to franchisor



### Activity 07

Few statements specifying the characteristics of different business organizations are given below.

01. Businesses having a continued existence and a separate legal identity that are owned by a single person
02. Businesses with an unlimited liability that are conducted by a combination of few people.
03. Businesses having an unlimited liability and no separate legal identity that are conducted by a single person

Read the above statements carefully and answer the following questions.

01. State the type of business organization that is explained by each of the statements.
02. Suggest business names to each of the business organizations.
03. Name laws, ordinances, Acts etc. that are applicable to each business organization.



### Activity 08

Name few franchises that are operating in Sri Lanka.

### Let's Answer

01. What are the common characteristics that can be seen in business organizations?
02. What are the basic characteristics of a sole proprietorship?
03. State the facts that can be included in a partnership agreement.
04. Classify business organizations according to the ownership.
05. Name the parties that are involved in a franchise agreement.

