FACULTY OF JURIDICAL SCIENCES

Lecture-19

2. Partnership Firm

As a business enterprise expands beyond the capacity of a single person, a group of persons have to join hands together and supply the necessary capital and skills. Partnership firm thus grew out of the limitations of one man business. Need to arrange more capital, provide better skills and avail of specialization led to the growth to partnership form of organization.
According to Section 4 of the Partnership Act, 1932 partnership is "the relation between persons who have agreed to share the profits of a business carried on by all or anyone of them acting for all". In other words, a partnership is an agreement among two or more persons to carry on jointly a lawful business and to share the profits arising there from. Persons who enter into such agreement are known individually as 'partners' and collectively as 'firm'.

Characteristics of Partnership

i. Association of two or more persons — maximum 10 in banking business and 20 in non-banking business
ii. Contractual relationship—written or oral agreement among the partners
iii. Existence of a lawful business
iv. Sharing of profits and losses
v. Mutual agency among partners
vi. No separate legal entity of the firm
vii. Unlimited liability
viii. Restriction on transfer of interest
ix. Utmost good faith.

Formation of Partnership:

A partnership firm can be formed through an agreement among two or more persons. The agreement may be oral or in writing. But it is desirable that all terms and conditions of partnership are put in writing so as to avoid any misunderstanding and disputes among the partners. Such a written agreement among partners is known as Partnership Deed. It must be signed by all the partners and should be properly stamped. It can be altered with the mutual consent of all the partners.

<u>A partnership deed usually contains the following details:</u>

i. Name of the firm.
ii. Names and address of all the partners.
iii. Nature of the firm's business.
iv. Date of the agreement.
v. Principal place of the firm's business.
vi. Duration of partnership, if any.
vii. Amount of capital contributed by each partner.
viii. The proportion in which the profits and losses are to be shared.
ix. Loans and advances by partners and interest payable on them.
x. Amount of withdrawal allowed to each partner and the rate of interest.
xi. Amount of salary or commission payable to any partner.
xii. The duties, powers and obligations of all the partners.
xiii. Maintenance of accounts and audit.
xiv. Mode of valuation of goodwill on admission, retirement or death of a partner.
xv. Procedure for dissolution of the firm and settlement of accounts.
xvi. Arbitration for settlement of disputes among the partners.
xvii. Arrangements in case a partner becomes insolvent.
xviii. Any other clause(s) which may be found necessary in particular kind of business.

<u>Merits of Partnership</u>:

The partnership form of business ownership enjoys the following advantages:

1. Ease of Formation:

A partnership is easy to form as no cumbersome legal formalities are involved. An agreement is necessary and the procedure for registration is very simple. Similarly, a partnership can be dissolved easily at any time without undergoing legal formalities. Registration of the firm is not essential and the partnership agreement need not essentially be in writing.

2. Larger Financial Resources:

As a number of persons or partners contribute to the capital of the firm, it is possible to collect larger financial resources than is possible in sole proprietorship. Creditworthiness of the firm is also higher because every partner is personally and jointly liable for the debts of the business. There is greater scope for expansion or growth of business.

3. Specialization and Balanced Approach:

The partnership form enables the pooling of abilities and judgment of several persons. Combined abilities and judgment result in more efficient management of the business. Partners with complementary skills may be chosen to avail of the benefits of specialization. Judicious choice of partners with diversified skills ensures balanced decisions. Partners meet and discuss the problems of business frequently so that decisions can be taken quickly.

4. Flexibility of Operations:

Though not as versatile as proprietorship, a partnership firm enjoys sufficient flexibility in its day-to-day operations. The nature and place of business can be changed whenever the partners desire. The agreement can be altered and new partners can be admitted whenever necessary. Partnership is free from statutory control by the Government except the general law of the land.

5. Protection of Minority Interest:

No basic changes in the rights and obligations of partners can be made without the unanimous consent of all the partners. In case a partner feels dissatisfied, he can easily retire from or he may apply for the dissolution of partnership.

6. Personal Incentive and Direct Supervision:

There is no divorce between ownership and management. Partners share in the profits and losses of the firm and there is motivation to improve the efficiency of the business. Personal control by the partners increases the possibility of success. Unlimited liability encourages caution and care on the part of partners. Fear of unlimited liability discourages reckless and hasty action and motivates the partners to put in their best efforts.

7. Capacity for Survival:

The survival capacity of the partnership firm is higher than that of sole proprietorship. The partnership firm can continue after the death or insolvency of a partner if the remaining partners so desire. Risk of loss is diffused among two or more persons. In case one line of business is not successful, the firm may undertake another line of business to compensate its losses.

8. Better Human and Public Relations:

Due to number of representatives (partners) of the firm, it is possible to develop personal touch with employees, customers, government and the general public. Healthy relations with the public help to enhance the goodwill of the firm and pave the way for steady progress of the business.

9. Business Secrecy:

It is not compulsory for a partnership firm to publish and file its accounts and reports. Important secrets of business remain confined to the partners and are unknown to the outside world.

Demerits of Partnership:

1. Unlimited Liability:

Every partner is jointly and severally liable for the entire debts of the firm. He has to suffer not only for his own mistakes but also for the lapses and dishonesty of other partners. This may curb entrepreneurial spirit as partners may hesitate to venture into new lines of business for fear of losses. Private property of partners is not safe against the risks of business.

2. Limited Resources:

The amount of financial resources in partnership is limited to the contributions made by the partners. The number of partners cannot exceed 10 in banking business and 20 in other types of business. Therefore, partnership form of ownership is not suited to undertake business involving huge investment of capital.

3. Risk of Implied Agency:

The acts of a partner are binding on the firm as well as on other partners. An incompetent or dishonest partner may bring disaster for all due to his acts of commission or omission. That is why the saying is that choosing a business partner is as important as choosing a partner in life.

4. Lack of Harmony:

The success of partnership depends upon mutual understanding and cooperation among the partners. Continued disagreement and bickering among the partners may paralyze the business or may result in its untimely death. Lack of a central authority may affect the efficiency of the firm. Decisions may get delayed.

5. Lack of Continuity:

A partnership comes to an end with the retirement, incapacity, insolvency and death of a partner. The firm may be carried on by the remaining partners by admitting new partners. But it is not always possible to replace a partner enjoying trust and confidence of all. Therefore, the life of a partnership firm is uncertain, though it has longer life than sole proprietorship.

6. Non-Transferability of Interest:

No partner can transfer his share in the firm to an outsider without the unanimous consent of all the partners. This makes investment in a partnership firm non-liquid and fixed. An individual's capital is blocked.

7. Public Distrust:

A partnership firm lacks the confidence of public because it is not subject to detailed rules and regulations. Lack of publicity of its affairs undermines public confidence in the firm.