

Lesson 6

Sole Proprietorship

We go to the market to buy items of our daily needs. In the market we find a variety of shops- some of them small and some of them big. We may find some persons selling vegetables, peanuts, newspapers etc. on the roadside. We may also find cobbler repairing shoes on the footpath. Everyday you come across such types of shops in your locality. But have you ever tried to know how these businesses are run? Who are the owners of these businesses? What exactly does an owner do for any business? You may say, the owner invests capital to start the business, takes all decisions relating to business, looks after the day to day functioning of the business and finally, is responsible for the profit or loss. Yes, you are right. The owner does exactly all these things. If you go a bit further, you will find that in some businesses a single individual and in some businesses a group of individuals perform all these activities. In this lesson let us find out more about the business in which a single individual takes all initiatives to start and run the business.

6.1 Objective

After studying this lesson, you will be able to:

- explain the meaning of sole proprietorship form of business organisation;
- list the characteristics of sole proprietorship;
- describe the advantage and disadvantage of sole proprietorship; and
- suggest the suitability of sole proprietorship form of business organisation.

6.2 Meaning of Sole Proprietorship

'Sole' means single and 'proprietorship' means ownership. It means only one person or an individual becomes the owner of the business. Thus, the business organisation in which a single person owns, manages and controls all the activities of the business is known as sole proprietorship form of business organisation. The individual who owns

and runs the sole proprietorship business is called a 'sole proprietor' or 'sole trader'. A sole proprietor pools and organises the resources in a systematic way and controls the activities with the sole objective of earning profit.

Is there any such shop near your locality where a single person is the owner? Small shops like vegetable shops, grocery shops, telephone booths, chemist shops, etc. are some of the commonly found sole proprietorship form of business organisation. Apart from trading business, small manufacturing units, fabrication units, garages, beauty parlors, etc., can also be run by a sole proprietor. This form of business is the oldest and most common form of business organisation.

Definition of Sole Proprietorship

We can now define sole proprietorship as–

A business enterprise exclusively owned, managed and controlled by a single person with all authority, responsibility and risk.

Intext Questions 6.1

Which of the following statements about sole proprietorship are **True** or **False**?

- i) The business is started by one person.
- ii) It is managed by employees of the business.
- iii) It is suitable for manufacturing of steel.
- iv) Sole proprietorship business includes only shopkeepers.
- v) The risk of the business is shared with the employees of the business.

6.3 Characteristics of Sole Proprietorship

Sole proprietorship form of business organisations have the following characteristics.

- i. Single Ownership**
- ii. No sharing of Profit and Loss**
- iii. One-man's Capital**
- iv. One-man Control**
- v. Unlimited Liability**
- vi. Less legal formalities**

Now we shall discuss each of the characteristics in details.

- i. Single Ownership:** A single individual always owns sole proprietorship form of business organization. That individual owns all assets and properties of the business. Consequently, he alone bears all the risk of the business. Thus, the business of the sole proprietor comes to an end at the will of the owner or upon his death.
- ii. No sharing of Profit and Loss :** The entire profit arising out of sole proprietor-

ship business goes to the sole proprietor. If there is any loss it is also to be borne by the sole proprietor alone. Nobody else shares the profit and loss of the business with the sole proprietor.

- iii. **One man's Capital :** The capital required by a sole proprietorship form of business organisation is totally arranged by the sole proprietor. He provides it either from his personal resources or by borrowing from friends, relatives, banks or other financial institutions.
- iv. **One-man Control:** The controlling power in a sole proprietorship business always remains with the owner. The owner or proprietor alone takes all the decisions to run the business. Of course, he is free to consult any body as per his liking.
- v. **Unlimited Liability:** The liability of the sole proprietor is unlimited. This implies that, in case of loss the business assets along with the personal properties of the proprietor shall be used to pay the business liabilities.
- vi. **Less Legal Formalities:** The formation and operation of a sole proprietorship form of business organisation requires almost no legal formalities. It also does not require to be registered. However, for the purpose of the business and depending on the nature of the business, the sole proprietorship has to have a seal. He may be required to obtain a licence from the local administration or from the health department of the government, whenever necessary.

Intext Question 6.2

Fill in the blanks with suitable word relating to sole proprietorship business.

- i) The owner of the business owns the properties and assets and bears all the _____ of the business.
- ii) All decisions for running the business are taken by the _____ .
- iii) The owner arranges capital for the business from _____ resources or loans.
- iv) The liability of the owner in the business is _____ .
- v) The business does not require registration and almost no _____ formalities.

6.4 Advantages of Sole Proprietorship

The sole proprietorship form of business is the most simple and common in our country. It has the following advantages:

- i. **Easy to Form and Wind up:** A sole proprietorship form of business is very easy to form. With a very small amount of capital you can start the business. There is no need to comply with any legal formalities except for those businesses which required licence from local authorities or health department of government. Just like formation it is also very easy to wind up the business. It is your sole discretion to form or wind up the business at any time.
- ii. **Direct Motivation:** The profits earned belong to the sole proprietor alone and he bears the risk of losses as well. Thus, there is a direct link between effort and

reward. If he works hard, then there is a possibility of getting more profit and of course, he will be the sole beneficiary of this profit. Nobody will share this reward with him. This provides strong motivation for the sole proprietor to work hard.

- iii. **Quick Decision and Prompt Action:** In a sole proprietorship business the sole proprietor alone is responsible for all decisions. Of course, he can consult others. But he is free to take any decision on his own. Since no one else is involved in decision making it becomes quick and prompt action can be taken on the basis of this decision.
- iv. **Better Control:** In sole proprietorship business the proprietor has full control over each and every activity of the business. He is the planner as well as the organiser, who co-ordinates every activity in an efficient manner. Since the proprietor has all authority with him, it is possible to exercise better control over business.
- v. **Maintenance of Business Secrets:** Business secrecy is an important factor for every business. It refers to keeping the future plans, technical competencies, business strategies, etc., secret from outsiders or competitors. In the case of sole proprietorship business, the proprietor is in a very good position to keep his plans to himself since management and control are in his hands. There is no need to disclose any information to others.
- vi. **Close Personal Relation:** The sole proprietor is always in a position to maintain good personal contact with the customers and employees. Direct contact enables the sole proprietor to know the individual likes, dislikes and tastes of the customers. Also, it helps in maintaining close and friendly relations with the employees and thus, business runs smoothly.
- vii. **Flexibility in Operation:** The sole proprietor is free to change the nature and scope of business operations as and when required as per his decision. A sole proprietor can expand or curtail his business according to the requirement. Suppose, as the owner of a bookshop, you have been selling books for school students. If you want to expand your business you can decide to sell stationery items like pen, pencil, register, etc. If you are running an STD booth, you can expand your business by installing a fax machine in your booth.
- viii. **Encourages Self-employment:** Sole proprietorship form of business organisation leads to creation of employment opportunities for people. Not only is the owner self-employed, sometimes he also creates job opportunities for others. You must have observed in different shops that there are a number of employees assisting the owner in selling goods to the customers. Thus, it helps in reducing poverty and unemployment in the country.

Intext Questions 6.3

Which of the following statements relating to sole proprietorship are true?

- i) Since the sole proprietor has to bear the risk of loss alone, there is no motivation to work hard.
- ii) Information about the customer's likes and dislikes is easily available to the sole proprietor.
- iii) Secrecy can be maintained in a sole proprietorship form of business organisation.

- iv) The business becomes rigid as changes in the nature of activities cannot be easily brought about.
- v) Such businesses generate employment opportunities for other people also, apart from the owner.

6.5 Limitations of Sole Proprietorship

One-man business is the best form of business organisation because of the above-discussed advantages. Still there are certain disadvantages too. Let us learn those limitations.

- i. **Limited Capital:** In sole proprietorship business, it is the owner who arranges the required capital of the business. It is often difficult for a single individual to raise a huge amount of capital. The owner's own funds as well as borrowed funds sometimes become insufficient to meet the requirement of the business for its growth and expansion.
- ii. **Unlimited Liability:** In case the sole proprietor fails to pay the business obligations and debts arising out of business activities, his personal properties may have to be used to meet those liabilities. This restricts the sole proprietor from taking risks and he thinks cautiously while deciding to start or expand the business activities.
- iii. **Lack of Continuity:** The existence of sole proprietorship business is linked to the life of the proprietor. Illness, death or insolvency of the owner brings an end to the business. The continuity of business operation is therefore uncertain.
- iv. **Limited Size:** In sole proprietorship form of business organisation there is a limit beyond which it becomes difficult to expand its activities. It is not always possible for a single person to supervise and manage the affairs of the business if it grows beyond a certain limit.
- v. **Lack of Managerial Expertise:** A sole proprietor may not be an expert in every aspect of management. He/she may be an expert in administration, planning, etc., but may be poor in marketing. Again, because of limited financial resources it is also not possible to employ a professional manager. Thus, the business lacks benefits of professional management.

Let Sum Up

Advantages	Limitations
<ul style="list-style-type: none"> • Easy to form and wind up • Direct Motivation • Quick Decision and Prompt Action • Better Control • Maintenance of Business Secrets • Close Personal Relation • Flexibility in Operations 	<ul style="list-style-type: none"> • Limited Capital • Unlimited Liability • Lack of Continuity • Limited Size • Lack of Managerial Expertise

6.6 Suitability of Sole Proprietorship Form of Business

Let us consider the type of businesses where sole proprietorship form is most suitable.

Sole proprietorship form of business organisation is suitable:

- Where the market for the product is small and local. For example, selling grocery items, books, stationery, vegetables, etc.
- Where customers are given personal attention, according to their personal tastes and preferences. For example, making special type of furniture, designing garments, etc.
- Where the nature of business is simple. For example, grocery, garments business, telephone booth, etc.
- Where capital requirement is small and risk involvement is not heavy. For example, vegetables and fruits business, tea stall, etc.
- Where manual skill is required. For example, making jewellery, haircutting or tailoring, cycle or motorcycle repair shop, etc.

Intext Questions 6.4

Fill in the blanks with suitable words in the following statements relating to sole proprietorship business:

- i) The sole proprietor may not be able to raise adequate _____ for the expansion of business.
- ii) The life of the business depends on the life of the _____ .
- iii) Due to limited financial resources and limitation of the expertise of the owner, the business may lack professional _____ .
- iv) The business is suitable for simple business where _____ skill is required.
- v) Sole proprietorship caters best to the needs of customers where the market for the product is _____ and _____ .

6.7 What You Have Learnt

- Sole Proprietorship is a form of business organization in which a single person owns, manages and controls the business enterprise with all authority, responsibility and risk. The individual who owns and runs the business is called the 'Sole proprietor'.
- In sole proprietorship business there is single ownership. The sole proprietor controls the business and his/her liability is unlimited. The proprietor bears the profit or loss and invests the capital from own sources. He/she may borrow it from friends and relatives or may take loan from banks and other financial institutions. Starting and operating the business does not require any legal formalities.
- Sole proprietorship business is easy to form and wind up. In this business, decisions are taken quickly, better control can be exercised over the business activities and

secrecy can be maintained. Owner is the sole beneficiary of profit of the business. Personal contact with customer and flexibility in operations is possible. Employment opportunity for the owner and for others is also created by this form of business organisation.

- The insufficiency of capital and unlimited liability of sole proprietor restricts the growth and expansion of sole proprietorship business. Life of the business is dependent on the life of the proprietor which leads to uncertainty in its continuity. This form of business organisations also suffer from the limitations of small size of the business and is deprived of the benefit of professional management.
- Sole proprietorship form of business is suitable for simple business involving less capital and low risk. Business requiring manual skill or personal attention to customers are generally organised in the form of sole proprietorship.

6.8 Terminal Exercise

1. Define 'Sole proprietorship'.
2. What is meant by Sole Proprietorship form of business organisation?
3. What is meant by one-man control in sole proprietorship form of business?
4. Can a sole proprietorship business exist forever? Justify your answer.
5. Describe how sole proprietorship facilitates employment generation.
6. In which conditions is sole proprietorship a suitable form of business organization?
7. State the main characteristics of sole proprietorship.
8. State four advantages and four limitations of sole proprietorship business.
9. How does unlimited liability lead to risk for the sole proprietor? Explain with the help of an example.
10. Explain how sole proprietorship business gives better control and prompt action. Illustrate your answer with suitable examples.
11. Define 'Sole Proprietorship'. Explain any four characteristics of this form of business organisation.
12. Describe any six advantages of sole proprietorship form of business organization.
13. What is meant by sole proprietorship? Discuss any four limitations of sole proprietorship form of business organisation.
14. 'Sole proprietorship form of business is the best form of business'. Do you agree with this statement? Justify your answer.

6.9 Key to Intext Questions

- 6.1** i) True, ii) False, iii) False, iv) False, v) False
- 6.2** i) risks, ii) proprietor, iii) personal, iv) unlimited, v) legal
- 6.3** i) False, ii) True, iii) True, iv) False, v) True
- 6.4** i) Capital, ii) Proprietor/owner, iii) Management, iv) Manual, v) Limited, localised.

Activity For You

- i. Survey the shops in your nearby market and make a list of different shops. Identify at least five business units owned by single individuals.
- ii. Ask any shopkeeper of a small shop in your locality about the problems faced by him in expanding his business activities.