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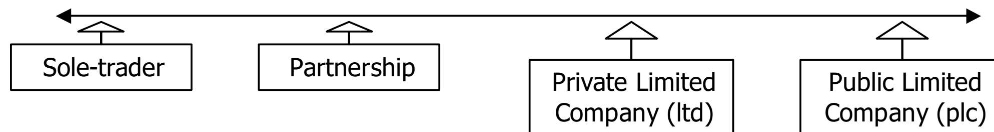
3RD OCTOBER 2003

Lesson Four | Unit: Objectives and Strategy

Business Organisations – Legal Structure

Business organisations are the **different legal forms a business** can adopt. The key distinction is that some businesses provide **limited liability** for any debts the business incurs. Others have **unlimited liability** – which obviously doesn't

Unincorporated | Incorporated



What is a Sole-trader? (Builder/local shops/hairdresser)

Sole-traders are individuals who **own** and **operate** their **own businesses**. Although there may well be other employees (usually no more than 5) the **final decisions** are made by the **'sole-trader'**. A sole-trader is the only one that **benefits financially** from the success, but must also face the **burden of any failures**.

Therefore, in the eyes of the law the business and the individuals are the same. This means that the sole-trader has **unlimited liability**.

What are the advantages and disadvantages of being a Sole -trader?

Advantages	Disadvantages
(1) Keeps all the profits	(1) Limited Capital (finance)
(2) Set your own agenda	(2) Long & hard hours
(3) Secretive business (except Taxman!)	(3) Unlimited liability

What does Unlimited Liability mean?

Unlimited liability means that owners are **liable for any debts incurred by the business**, even if it requires them to sell all there assets and possessions and become **personally bankrupt**.

What is a Partnership? (Doctor's Practice)

To overcome many of the problems of a sole trader, a partnership may be formed. A partnership is an association of individuals and generally there will be between 2 and 20 partners.

Each partner is responsible for the debts of the partnership and therefore you would need to choose your partners carefully and draw up an agreement on the responsibilities and rights of each partner (known as a **Deed of Partnership** or **The Articles of Partnership**).

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The most common examples of a partnership are doctor's surgeries, veterinarians, accountants, solicitors and dentists.

As stated earlier, most partners in a partnership face **unlimited liability** for their debts. The only exception is in a **Limited Partnership**. This is where a partnership may wish to raise additional finance, but does not wish to take on any new active partners.

To overcome this problem, the partnership may take on as many Sleeping (or Silent) Partners as they wish – these people will provide finance for the business to use, but will not have any input into how the business is run. In other words, they have purely put the money into the business as an investment. These Sleeping Partners face limited liability for the debts of the partnership. A partnership, just like a sole trader, is an unincorporated business.

What are the advantages and disadvantages of a Partnership?

Advantages	Disadvantages
(1) Additional Skills to strengthen the business	(1) Share profits
(2) More capital to help business	(2) Loss of control
(3) Debts are shared equally	(3) Unlimited liability

There are two types of companies, which can be formed:

Private Limited Company (Ltd.)

Often private limited companies are small, family run businesses which are owned by shareholders.

Each shareholder in a private limited company **MUST** be a part of the business and under no circumstances can any shares be sold to members of the general public.

Each shareholder has **limited liability** for the company's debts and can, therefore, only lose the value of their investment in the company. A company is run by a **Board of Directors** (who are elected by the shareholders) and this is **headed by a Chairman**.

Before a company can be formed, a number of legal documents must be completed – most important are the **Memorandum of association** and the **Articles of Association**. **These cover details such as :**

- the objectives of the business

- its headquarters and registered office

- the amount of capital to be raised from the sale of shares

- details concerning meetings within the business

- the arrangements for auditing the accounts of the business.

When these are completed, they are sent to the **Registrar of Companies**, who will then issue the business with a **Certificate of Incorporation** which allows the business to trade as a Private Limited Company. The company's name must finish with the word **Limited** and it must raise less than £50,000 of share capital.

<u>What are the advantages and disadvantages of a Private Limited Company?</u>

<u>Advantages</u>	<u>Disadvantages</u>
(1) Limited Liablity	(1) Share Capital must not exceed £50,000
(2) Can't be taken over as easily	

<u>What is Limited Liability?</u>

This is the idea that the owners of a company (shareholders) are only responsible for the amount of money that they have invested into the company, rather than their personal assets. Thus if a firm becomes insolvent, the maximum that creditors can receive is the shareholders' initial investment. The word 'Ltd' or 'PLC' appear after the company's name to inform creditors that the business has limited liability.

<u>Public Limited Company (Plc.)</u>

This is the other, much larger, type of joint-stock company. A PLC is an incorporated business, run by the **Board of Directors** on behalf of the shareholders and has an A.G.M. (Annual General Meeting) at which shareholders vote on certain key issues relating to the company.

The main difference between a PLC and a private limited company is that a PLC can **sell its shares on the Stock Exchange** to members of the general public and can, therefore, raise significantly more finance than a private limited company.

If a private limited company wishes to become a PLC, then it must change its Memorandum and Articles of Association and re-submit them to the Registrar of Companies.

If the company is considered to have acted legally and for the best interests of its shareholders, then it will be issued with a new Certificate of Incorporation and also with a Certificate of Trading, which will allow it to sell its shares on the Stock Exchange. The price of the shares will then fluctuate according to investors' perceptions of the PLC.

It is often the case with a PLC that the owners of the company (shareholders) will wish the PLC to make as much profit as possible, so that the shareholders will receive a very handsome dividend per share.

However, the Board of Directors and the management will often wish to devote some of the PLC' s resources to growth and diversification (such as

the introduction of new products) and this will clash with the shareholders' desire for maximum profits. This is known as the **divorce of ownership and control**.

The PLC **has to publish its annual accounts** (known as disclosure of accounts) and therefore is extremely vulnerable to investors' and bankers' perceptions about its progress and success. Following on from this, a PLC is also at risk from a takeover from an outside body, if they manage to accumulate over 50% of the shares in the PLC.

Public Sector Organisations

The public sector refers to all the businesses and organisations which are **accountable to central or local government**. They are funded directly by the government and they tend to supply public services rather than produce products for a profit.

The public sector provides 3 types of good / service.

- **A public good** is one which would not be provided by private sector businesses because it would not be profitable to do so (such as the emergency services and the armed services).

- **A merit good** is one which the government feel that everyone should have, whether or not they could afford them in the private sector (such as education and healthcare).

- **Essential services** (such as street lighting, refuse collection, street cleaning, parks, libraries, swimming pools, etc.).

A public corporation is the term used to describe a **nationalised industry** which is providing a good or a service to the general public. Until the successive Conservative governments of Thatcher and Major (1979-1997), there were many public corporations in the UK providing a huge range of services to consumers. However, the Conservatives sold many of these public corporations to the private sector – this process is known as **privatisation**.

Central government pays for the public goods and merit goods through taxation (e.g. Income Tax), whereas local governments pay for the services they provide through Council Tax (formerly Community Charge and, before that, through Rates).

Franchising

Franchising has led to a rapid growth in the presence of many high-street stores in the UK over the past 10 years (e.g. McDonalds, Tie Rack, Perfect Pizza, and The Body Shop). A business franchise involves the **franchisor** (the owner of the business) selling a business format to a **franchisee** (the purchaser of the business name) in return for a fixed sum of money and a percentage royalty on sales revenue.

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The **franchisee** will be based locally and is likely to be making his initial business venture. He buys the business format, which has been tried and tested in other areas, and it is therefore a far less risky venture than setting up his own business.

The **franchisee** has a licence to trade under the franchiser's name and also to use the logos, trademarks, etc. the licence that the franchisee buys is usually restricted to a specific geographical area and for a limited period of time.

This process of selling the rights to use a company's name, logo, etc. can result in the parent company experiencing rapid expansion in a country, with little of the investment that would have been required had the company bought the outlets itself. The franchisee is provided with a ready-made product, financial and management help and advice, lower start-up costs than for a business of his own, and help with the store layout.

However, the royalty must be paid to the franchisor even if a loss is made and the franchisee can have strict restrictions placed on their actions and promotions within the store, not leaving the franchisee much room for initiative and flair.