Building Law Assessment 1
26-4624-00S

Introduction

There are various different types of business organisation recognised in the English Legal System. There are four organisations that I will explain during this assessment. These are the sole trader, partnerships, private limited companies and public limited companies. A sole trader is a single individual who sets up a business, the identity of which is indistinguishable from that of its owner. Partnerships consist of two or more persons, usually with a maximum number of twenty. A Private Limited Company is usually family run and the owners have different liability to the other forms of business organisation mentioned previously. This will be explained later. The owners of a Public Limited Company (PLC) have the same liability as limited companies with the major difference being that a PLC company is open for public investment.

These are not the only forms of business organisation. There are also co-operative companies, charities, building societies and other forms of organisation. In this assessment I will focus on the main four organisations briefly mentioned previously.

Various Forms of Business Organisation

Business Organisations are most commonly classed in terms of the size, the type of ownership (public, private etc), legal form (sole trader, limited company) and the industry sector. A business's legal form often relates to the level of resources it has available for marketing, its size and its objectives.

Sole Trader

The sole trader is the most basic form of business organisation and is the easiest organisation to set up resulting in over 80% of U.K companies to be operated by sole traders. The company that a sole trader sets up is indistinguishable to the sole trader meaning that individual has full, unlimited liability of the business. The individual to set up the business accepts all legal responsibility and takes on all of the rights and duties of the business. If the business is sued by a third party and the company does not have the assets or capital to meet the claim, then the private assets of the individual can be ceased.

Due to the ease of setting up as a sole trader, it is hard to keep track of how many sole traders are set up. The government set an amount of revenue that a sole trader could receive before they had to declare their company for tax purposes and keep a record of their accounts and sales etc, but sole traders annual revenue is difficult to prove if some of their sales etc are not recorded. This may be one of the advantages of setting up as a sole trader rather than a limited company.

There are many advantages and disadvantages of setting up as a sole trader rather than a limited company or a partnership, the first major advantage being that the individual maintains full operational control over the company and can also keep 100% of the profit rather than having to split it with other partners. There are also various tax and national insurance benefits that a sole trader has, e.g. claiming back the VAT on items that will be used for business use, such as mobile phones etc.

The main disadvantage facing sole traders is the fact that they have unlimited liability meaning that the individuals company is indistinguishable from the individual, as mentioned previously. This brings about major problems when sole traders are in competition with much larger firms that are able to exploit the economies of scale, leading to the sole traders personal assets being ceased if the company enters debt.

Sole traders do not have the same access to capital as larger companies do. Capital is only provided by the individual or by close personal investors. Banks may provide a loan but it will be backed against the individual's personal assets. A partner may therefore be called to enter the company to provide more capital and more management skills so that the company does not fail and may provide scope for expansion of the company.

Partnerships

The Partnership Act 1890 defines a partnership as ‘the relation that subsists between persons carrying on a business with a view to profit’. A partnership has two to twenty members who are in a contract called a deed of partnership, which states how much capital each of the partners has contributed, how profits and losses will be shared, management responsibilities of each partner, the allocation of salaries and the procedures for ending the partnership with details of how assets of the company will be split.

One of the main disadvantages of a partnership is again unlimited personal liability for the debts of the business. Furthermore, each partner has personal liability of the mistakes made by other partners, which brings about a second disadvantage of shared responsibility that can also be looked at as an advantage. There will be many disputes over various decisions that have to be made or about the effort that one partner is putting into the company compared to another. The deed of partnership will state the distribution of profit amongst the partners but if one individual feels that one of the partners is not putting in as much work to the company as another then there will be disputes over the profit distribution.

A further complication of a partnership is the distribution of assets if the company was to fail or if one of the partners was to leave the partnership at all. The deed of partnership would explain their share in the company but would not explain which assets are which partners.

The main advantage of a partnership over a sole trader is shared responsibility, which allows for specialisation, where one persons expertise can complement another. There will be more people contributing capital into the company, which allows more flexibility in the company and allows further scope for expansion due to banks being more willing to lend money.

Private Limited Companies (Ltd's)

In the nineteenth century, it was realised that there would only be very slight industrial development if individuals risked losing all of their personal assets to cover debt of a company that they may not always have full operational control over. The response to this need was the Joint Stock Companies Act 1844 which stated a distinction between the owner's personal assets and the assets of the company, making the company a separate legal identity. This was named a limited company due to the limited liability upon the owner's. The present piece of law to govern this is the Companies Act 1985.

As with the other business organisation mentioned previously, there are many advantages and disadvantages to this type of organisation, the main advantage being that there is limited liability that is also protected by legislation therefore protecting the owner's personal assets.

The formation of a private limited company is fairly complicated and time consuming compared to the likes of the sole trader or a partnership. An added complication is the private limited company having to show its annual accounts and revenue for tax purposes. This is much easier to avoid when working as a sole trader.

Raising additional capital is usually a lot easier for a private limited company although banks and independent loan companies may sometimes ask for personal asset guarantees to cover the loan. This widens the scope for expansion of the private limited company with the added advantage of being able to become a public limited company.

Public Limited Companies (PLC's)

The Companies Act 1985 brought about the public limited company when it recognised that there was not much distinction between the small, often family run private limited company and the large multinational public limited companies. A public limited company has the same legal separation as the private limited company apart from some small differences.

The major difference of a public limited company is that it is open for the public to invest into, which is highly illegal for a private company. The Companies Act 1985 states that for a public limited company to set up it must have a minimum share capital of £50,000 and at least two directors .The private limited company only has to have a minimum of £100 and one director, therefore showing that the majority of PLC's are much larger than private limited companies.

The main advantage of a public limited company is that it can offer shares to members of the public enabling public investment and increased capital for the company. This is the key way for a private limited company to expand when they feel that they have exhausted all existing equity capital.

You may notice that a lot of public companies put the letters 'PLC' at the end of their company name when advertising etc, giving potential customers greater confidence to invest in the company or to buy their products. This may not always be considered an advantage due to the public being able to access their financial information and previous performance figures e.g. www.bloomberg.com, which may alter their interest to invest in the company or buy the companies products.

Another major disadvantage of a public limited company is the amount of capital and number of directors it has to have before it can obtain a business certificate from the Registrar of companies. This is time consuming and some companies may not have the correct amount of capital in their company to be able to register.

Conclusion

It is difficult to define an ideal business organisation due to all having their advantages and disadvantages. The choice of a business organisation usually depends on its size, ownership, legal form and the industry sector. Small companies such as hairdressers tend to run by sole traders, larger firms such as solicitors, dentists etc, tend to be run by more than two individuals in a partnership due to the increased workload and capital needed. Sole traders and partnerships have unlimited liability meaning that their personal assets may be ceased if the company enters debt and the owners may therefore decide to cut their risk and change their company to a limited company, either private or public. This limits their potential risk to losing only the assets of the company and not their own personal assets, therefore giving the company more scope for expansion.

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