

Business organisation – Limited Companies

A limited company is a business that is owned by its shareholders, run by directors and **most importantly** whose liability is limited.

Limited liability means that the investors can only lose the money they have invested and no more. This encourages people to finance the company, and/or set up such a business, knowing that they can only lose what they put in, if the company fails.

For people or businesses who have a claim against the company, “limited liability” means that they can only recover money from the existing assets of the business. They cannot claim the personal assets of the shareholders to recover amounts owed by the company.

To set up as a limited company, a company has to register with **Companies House** and is issued with a **Certificate of Incorporation**. It also needs to have a **Memorandum of Association** which sets out what the company has been formed to do, and **Articles of Association** which are internal rules over including what the directors can do and voting rights of the shareholders.

Limited companies can either be private limited companies or public limited companies.

The difference between the two are:

- ▶ **Shares in a public limited company (plc)** can be traded on the Stock Exchange and can be bought by members of the general public. Shares in a private limited company are not available to the general public; and
- ▶ The **issued share capital** of a plc (the initial value of the shares put on sale) must be greater than £50,000 in a plc. A private limited company may have a smaller share capital

A private limited company might want to become a “plc” because:

- ▶ Shares in a private limited company cannot be offered for sale to the general public, so restricting availability of finance, especially if the business wants to expand. Therefore, it is attractive to change status
- ▶ It is also easier to raise money through other sources of finance e.g. from banks

[Note: becoming a “plc” does not necessarily mean that the company is quoted on the Stock Exchange. To do that, the company must do a “flotation” (see below)]

The disadvantages of a being a public limited company (plc) are:

- ☒ Costly and complicated to set up as a plc – need to employ specialist bankers and lawyers to help organise the converting to the plc.
- ☒ Certain financial information must be made available for everyone, competitors and customers included (would you want them to know how much profit you are making?)
- ☒ Shareholders in public companies expect a steady stream of income from dividends, which might mean that the business has to concentrate on short term objectives of creating a profit, whereas it might be better to work on longer term objectives, such as growth and investment.
- ☒ Threat of takeover, because another company can buy up a large number of shares because they are traded publicly (can be sold to anyone). If they buy enough, they can then persuade other shareholders to join with them to vote in a new management team.

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Shareholders own the company. They buy shares because:

- ▶ Shares normally pay dividends, which is a share of the profits at the end of the year. Companies on the Stock Exchange usually pay dividends twice each year.
- ▶ Over time the value of the share may increase and so can be sold for a profit – this is known as a “capital gain”. Of course, the price of shares can go down as well as up, so investing in shares can be very risky.
- ▶ If they have enough shares they can influence the management of the company. A good example is a “venture capitalist” that will often buy up to 80% of the shares of a company and insist on choosing some of the directors.

Flotation

A company may float on the stock market. This means selling all or part of the business to outside investors. This generates additional funds for the business and can be a major form of fund raising. When shares in a “plc” are first offered for sale to the general public as the company is given a “listing” on the Stock Exchange.

Divorce of ownership and control

As a business becomes larger, the ownership and control of the business may become separated. This is because the shareholders may have the money, but not the time or the management skills to run the company. Therefore, the day-to-day running of the business is entrusted to the directors, who are employed for their skills, by the shareholders.

The shareholders are therefore “divorced” from the running the business for 364 days of the year. They will have their say at the Annual General Meeting (AGM) of the company, where the directors present the accounts and results. Very recently a couple of businesses have had very strong shareholder unrest leading the company to tone down a number of their decisions.

In practice directors tend to have at least a modest shareholding in the company. This provides the director with an incentive to achieve good dividends and capital growth for the share (an increase in the share price).

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