Types of Business Organisation
Introduction

- A business is always owned by someone. This can just be one person, or thousands. So a business can have a number of different types of ownership depending on the aims and objectives of the owners.

- Most businesses aim to make profit for their owners. Profits may not be the major objective, but in order to survive a business will need make a profit in the long term.

- Some organisations however will be ‘not-for-profit’, such as charities or government-run corporations.
Key Learning Points

- What are the different types of business organisation?
- What are the advantages and disadvantages of each type?
- What are the implications of the choice of business organisation on key issues such as:
  - Ability to raise finance
  - Control of the business
  - Business aims and objectives
Main types of business organisation

- Sole trader
- Partnership
- Private Limited Company ("Ltd")
- Public Limited Company ("plc")
- Co-operatives
- Franchises
- Public sector
Measuring size of a business

No one measure of the size of the business

Options

- Number of employees
- Number of outlets (e.g. shops)
- Total revenues (or “sales” per year)
- Profit
- Capital employed – amount invested in business
- Market value

Often need to consider several measures together

Business size is “relative” – e.g. how large is a business compared with its main competitors?
Sole Traders

- A sole trader is a business that is **owned by one person**
- It may have one or more employees
- The most common form of ownership in the UK
- Often succeed – why?
  - Can offer specialist services to customers
  - Can be sensitive to the needs of customers – since they are closer to the customer and react more quickly
  - Can cater for the needs of local people – a small business in a local area can build up a following in the community due to trust

Key legal points

- **Keep proper business accounts and records** for the Inland Revenue (who collect the tax on profits) and if necessary VAT accounts
- **Comply with legal requirements** that concern protection of the customer (e.g. Sale of Goods Act)
Operating as a sole trader

ADVANTAGES

- Total control of business by owner
- Cheap to start up
- Keep all profit

DISADVANTAGES

- Unlimited liability
- Difficult to raise finance
- May be difficult to specialise or enjoy economies of scale
- Problem with continuity if sole trader retires or dies
Unlimited liability

- An important concept – it adds to the risks faced by the sole trader
- Business owner responsible for all debts of business
- May have to sell own possessions to pay creditors
Sole trader forming a partnership

- Spreads risk across more people
- Partner may bring money and resources to business
  - E.g. better premises to work from
- Partner may bring other skills and ideas to business
- Increased credibility with potential customers and suppliers – who may see dealing with business as less risky
Partnership

- Business where there are two or more owners of the enterprise
- Most partnerships have between two and twenty members though there are examples like the major accountancy firms where there are hundreds of partners
- A partner is normally set up using a Deed of Partnership. This contains:
  - Amount of capital each partner should provide
  - How profits or losses should be divided
  - How many votes each partner has (usually based on proportion of capital provided)
  - Rules on how to take on new partners
  - How the partnership is brought to an end, or how a partner leaves
Advantages of Partnership

- Spreads the risk across more people, so if the business gets into difficulty then there are more people to share the burden of debt
- Partner may bring money and resources to the business
- Partner may bring other skills and ideas to the business, complementing the work already done by the original partner
- Increased credibility with potential customers and suppliers – who may see dealing with the business as less risky than trading with just a sole trader
Disadvantages of a partnership

- Have to share profits
- Less control of business for individual
- Disputes over workload
- Problems if partners disagree over direction of business
Limited company

- Business owned by shareholders
- Run by directors (who may also be shareholders)
- Liability is limited (important)
Setting up a limited company

- Company has to register with Companies House
- Issued with a Certificate of Incorporation
- **Memorandum of Association** - describes what company has been formed to do
- **Articles of Association** - internal rules covering:
  - What directors can do
  - Voting rights of shareholders
Controls of a company

- Shareholders own company
- Company employs directors to control management of business
- The directors may also be shareholders (most are)
- Directors are responsible to shareholders
  - Have a duty to act in best interests of shareholders
  - Have to account for their decisions and performance (Accounts)
Importance of limited liability

- Limited liability means that investors can only lose money they have invested.
- Encourages people to finance company.
- Those who have a claim against company:
  - Limited liability means that they can only recover money from existing assets of business.
  - They cannot claim personal assets of shareholders to recover amounts owed by company.
Separate ownership and management of a company

- Shareholders may have money
- May not have time or management skills to run company
- Day to day running of business is entrusted to directors
- Directors employed for their skills & experience
Differences between a private and public limited company

- Shares in a **plc** can be traded on Stock Exchange and can be bought by members of general public
- Shares in a private limited company are not available to general public
- Issued share capital (initial value of shares put on sale) must be greater than £50,000 in a plc
- A private limited company may have a smaller (or larger) capital.
Reasons for a private limited company to become a “plc”

- Shares in a private company cannot be offered for sale to the general public.
- Restricts availability of finance, especially if the business wants to expand.
- 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”.
Disadvantages of being a plc

- Costly and complicated to set up as a plc
- Certain financial information must be made available for everyone, competitors and customers included
- Shareholders in public companies expect a steady stream of income from dividends
- Increased threat of takeover
Flotation

- When shares in a “plc” are first offered for sale to general public
- Company is given a “listing” on Stock Exchange
- Opportunity for company to raise substantial funds
- Complex and expensive process
Buying shares in a company

- Shares normally pay dividends (share of profits)
- Companies on Stock Exchange usually pay dividends twice each year
- Over time value of share may increase and so can be sold for a profit (known as a “capital gain”)
- Of course, price of shares can go down as well as up, so investing in shares is risky.
- If they have enough shares they can influence management of company
- Good example is a “venture capitalist”
  - Will often buy up to 80% of shares of a company and insist on choosing some of directors
Risks faced by company shareholders

- Company reduces its dividend or pays no dividend
- Value of share falls below price shareholder paid
- Company fails and investor loses money invested
Main forms of co-operative

Three main types of co-operative
- Retail co-ops
- Marketing or trader co-ops
- Workers co-ops

Examples:
- Co-operative Retail Society
- Farmer’s co-operatives marketing and distributing food products
- Small business credit unions
- Artists’ co-operatives sharing studio and exhibition facilities
Examples of franchises in the UK

- McDonalds
- Clarks Shoes
- Pizza Hut
- Holiday Inn
Franchises

- **The franchisor** is the business whose sells the right to another business (franchisee) to operate a franchise
  - Franchisor may run a number of their own businesses, but also may want to let others run the business in other parts of the country

- A franchise is bought by the **franchisee**
  - Franchisee required to invest – often around £10,000 - £50,000 in acquiring the franchise licence and setting up the business
  - Once they have purchased the franchise they have to pay a proportion of their profits to the franchisor on a regular basis
  - Depending on the business involved, the franchiser may provide training, management expertise and national marketing campaigns
  - May also supply the raw materials and equipment.
Advantages and disadvantages of franchising

- **Advantages**
  - Tried and tested market place, so should have a customer base
  - Easier to raise money from bank to buy a franchise
  - Given right and appropriate equipment to do job well
  - Normally receive training
  - National advertising paid for by franchisor
  - Tried and tested business model

- **Disadvantages**
  - Cost to buy franchise
  - Have to pay a percentage of your revenue to business you have bought franchisor
  - Have to follow franchise model, so less flexible
Reasons why franchising has become more popular

- Large companies have seen it as a means of rapid expansion
- Franchisee provides most of finance – reduces investment in expansion
- Local entrepreneur with inherited or redundancy money sees opportunity to set up business with reduced risk
- Banks like combination of large company and small local business as a reduced lending risk.
Reasons for public sector organisations

- Provide essential services not fully provided by private sector
- Prevent exploitation of customers
- Avoid duplication of resources
- Protect jobs and maintain key industries
Reasons for privatisation of public organisations in UK

- State run firms perceived to be inefficient
- No incentive to cut costs or provide high quality services because there is no competition
- State-run firms can be a financial burden on government
- Selling them off raises valuable money for government
Disadvantages of privatisation

- Private companies may put prices up
- Cut jobs and reduce services that are not profitable
- Disadvantages the needy