1 Introduction to Small Business

Introduction

Welcome to the study of small business accounting.

A small business is defined by the Australian Bureau of Statistics as a business employing less than 20 people.

Small business plays a significant role in supplying many of the products that we use each day. When we buy milk from our local delicatessen or have our hair cut or purchase a magazine from a newsagency we are using products or services supplied by a small business.

Types of Businesses

Businesses can be divided into manufacturing, trading and service types.

A Manufacturing Business

A manufacturing business converts raw materials, such as, wood, clay or cloth into finished products, such as, toys, coffee mugs or dresses.

A Trading Business

A trading business buys and sells inventory. **Inventory** mainly consists of products purchased by a business with the intention of re-selling these products at a profit.

Examples
Shops that sell computers, books or furniture.

There are two types of trading businesses: retailers and wholesalers.

A **retailer** is a business that sells inventory to the public.

A **wholesaler** is a business that purchases inventory from a manufacturer and sells this inventory to a retailer.

A Service Business

A service business provides a service to a customer in exchange for a fee.

Examples
A solicitor, an accountant and a hairdresser.

Social and Ethical Factors Affecting a Business

The aim of a business is to make a profit. Many successful businesses also choose to make a contribution to the community. This can be done in a number of ways including resource conservation and the support of community causes.

Resource conservation – by recycling as much waste as possible and reducing the energy consumption of the business.

Set out below are some resource conservation suggestions.

1 Turn off the light when an office is not occupied.

2 Cut down on the amount of paper used in the office.

3 Recycle toner printer cartridges.

4 Use public transport when travelling to and from the business workplace or car pool.

Resource conservation will save a small business money.

Support of community causes – by, for example, contributing to a charity or to a medical research fund or by sponsoring a local netball or football club.

Example
The employees of Starbucks, the coffee shop chain, are given one day off a year to work in a charity of their choice.

Supporting community causes will improve the image of a small business and may lead to increased sales.

Taxation responsibility– a business has a responsibility to accurately calculate the amount of tax payable each year and pay all taxes owing.

Small Business Start-up Legislation

There are a number of laws that affect the start-up phase of a small business.

A person who intends to start a small business may have to:

register a business name

register for, charge and collect the goods and services tax (GST).

Goods and Services Tax (GST) Requirements

A business may have to register for and collect the goods and services tax. The GST requirements of operating a business are discussed in chapter 5.

Registration of a Business Name

When a person starts a business they will often have to register a business name with the Australian Securities and Investments Commission.

If the name of a business only consists of the owner's name is does not have to be registered. If Stephanie Brown starts a business named Stephanie Brown, she will **not** have to register a business name.

If a person starts a business that has as its name, the name of the owner and one or more words, the name will have to be registered. If Stephanie Brown starts a business titled Stephanie Brown Accountant she will have to register a business name.

A business name is registered for a period of three years and must be re-registered at the end of that period.

A fee is charged for the registration of a business name.

Some names cannot be registered. These names include a name that is the same or similar to a business name that has already been registered.

Bankruptcy

A person is insolvent if they cannot pay their debts when they become due.

Personal insolvency is covered by the Bankruptcy Act (Cwlth) 1966 and is commonly known as bankruptcy. Once a person becomes bankrupt most of their assets will be sold to repay their debts. Bankruptcy usually lasts for three year.

A person or a company may have two types of creditors. A secured creditor has the right to seize and sell some or all of the assets of a debtor. An unsecured creditor has no right to seize and sell the assets of a debtor.

A person who is struggling to repay debts has a number of options under the Bankruptcy Act. These options are:

1 a declaration of intention to present a debtor's petition

2 a debt agreement

3 a personal insolvency agreement

4 voluntary bankruptcy.

Declaration of Intention to Present a Debtor's Petition

A person who is struggling to repay debts may hand in a debtor's petition to the Insolvency and Trustee Service Australia (ITSA).

After a debtor's petition is presented to ITSA an unsecured creditor cannot take action to recover money owing for 21 days.

The aim of presenting a debtor's petition is to give the debtor time to enter into an agreement with their creditors to repay the money owing and to avoid bankruptcy.

A Debt Agreement

A debt agreement is a contract between an individual and their creditors. The agreement must be accepted by the majority of the creditors (in terms of the amount of money owed).

A debt agreement may provide that the debtor pays a lump sum that is less than the full amount owing or pays off the amount owing in instalments.

A debt agreement can only be made if the size of the unsecured debts, assets and after-tax income of the individual seeking the agreement is below a set limit.

A Personal Insolvency Agreement

A personal insolvency agreement is a contract between an individual and their creditors to repay part or all of the amount owing.

The personal insolvency agreement must be approved by a special resolution of the creditors. A special resolution requires a 75% majority in favour of the resolution based on the dollar value of the amount owed. A trustee must be appointed to administer the agreement.

There is no limit on the size of the debts, assets or after-tax income of the individual seeking a personal insolvency agreement.

Voluntary Bankruptcy

A person who is unable to make a repayment agreement with his or her creditors can petition for bankruptcy.

Once a person has become bankrupt the assets that they are not allowed to keep, such as, a house, will be sold to repay their debts.

Involuntary Bankruptcy

Involuntary bankruptcy occurs when a creditor applies to a court to have a person made bankrupt. Most of the assets of the debtor are then sold to repay the creditors.

Questions

✍	*Questions 1 to 6: introduction to small business*

Question 1

Which one of the following is a small business?

a A newspaper employing 240 people.

b A business college employing 20 people.

c A furniture manufacturer employing 19 people.

d A dress shop employing 3 people.

Question 2

Which one of the following is a trading business?

a A solicitor

b A courier (delivering parcels across the city)

c A shop that sells jewelry

d A plumber

Question 3

A **wholesaler** is:

a a business that sells products to the public

b a business that imports products

c a business that purchases products from a manufacturer and sells these products to a retailer

d none of the above

Question 4

A **retailer** is:

a A business that sells products to the public

b A business that purchases products from a manufacturer and sells these products to another business

c A business that provides a service, such as, a furniture mover or a marketing consultant.

Question 5

The following events in the life of Madison occurred on a Tuesday.

At 7.30 am Madison drove to work. Madison works for the Grow Nursery. This business has 11 employees and has over 300 different plant varieties for sale.

At 12.30 pm, during her lunch break, Madison withdrew $200 from the Commonwealth Bank and took her watch to the On Time Watch Repair Shop to be fixed.

Madison also stopped at the Hair Princess Salon to arrange to have her hair cut on Saturday.

At 4.00 pm Madison left work and stopped at her local delicatessen to buy a litre of milk, a magazine and a packet of tissues.

At 4.10 pm Madison drove to Ted's Video Shop and rented a DVD from the shop owner, Ted, to watch that night. At 4.30 pm Madison arrived home.

At 4.50 pm a plumber from the business known as Tap and Washer called to repair a leaking tap in her kitchen.

Required

1 Which of the businesses named above are likely to be small businesses?

2 What two major contributions do small businesses make in the lives of many people in Australia? Use examples from a day in the life of Madison to support your answer.

3 Divide each of the businesses named above into trading and service types.
Note: some service business also sell products.

	Question 6 covers the topic of business social responsibility

Question 6

Patricia Houlahan is the owner of the Success Business College. The college has been in existence for 10 years and has been very successful. Patricia would like to give something back to the community. Patricia would like her business to be involved in two projects that will benefit the community.

Required

1 Suggest two community projects that Patricia could support or introduce into her business.

2 How might the Success Business College benefit from the introduction of these community projects?

2 Types of Business Ownership

Introduction

A person who intends to start a business has to choose an ownership structure for the business.

Business Ownership Structures

Three common ownership structures of a business are:

1. a sole trader
2. a partnership, and
3. a company.

Sole Trader

A sole trader is a business owned by one man or one woman.

A sole trader can, for example, run a delicatessen or operate a business as a plumber, an accountant or a watch repairer.

Advantages of being a Sole Trader

1. A business operated by a sole trader is easy to establish.
2. A sole trader does not have to share the profit with other owners.

Disadvantages of being a Sole Trader

1. A sole trader is liable for all the debts of the business. If the business property is not sufficient to cover the business debts, the personal property of the sole trader, such as a house or a motor vehicle, can be sold and the money used to re-pay the debts.
2. One person may not have enough money to start or expand a business.
3. A sole trader has limited sources of advice when making business decisions.
4. The business may have to close or be sold if the sole trader has a serious illness.
5. Any losses made by the business cannot be shared with other owners.
6. The sole trader will find it more difficult to take annual holidays unless he or she has family members or employees who have the honesty and the skills needed to run the business in the absence of the owner.

Partnership

A partnership is a business, other than a company, that is owned by two or more people.

The number of members of a partnership is limited by law. The maximum size of most partnerships is 20 people.

Advantages of a Partnership

1 Two or more partners may be able to raise more capital than can one sole trader.

2 Partners may be able to contribute different skills to a business.

3 Partners can share the workload of operating a business.

4 One partner can cover for another partner who is sick or on holidays.

5 Partners share the risks of the business and any losses.

Disadvantages of a Partnership

1 Partners are jointly and severally liable for the debts of the partnership. This means that the partners, together, are liable for all the debts of the partnership and the partners, as individuals, are liable for all partnership debts.

2 Conflict over business policy or personality clashes can occur. These can be serious enough to end the partnership.

3 A partnership has a limited life. The death or retirement of a partner ends the partnership unless there is a prior agreement that the partnership will continue. If there is no such agreement the surviving partners must either form a new partnership or close the business.

4 Any profit made by the business must be shared between a number of people.

Partnership Agreement

When two or more people decide to operate a business as a partnership they should prepare a written partnership agreement.

A partnership agreement sets out the important features of the partnership. A partnership agreement usually includes, among other terms, the following:

1 the aims of the partnership

2 the profit or loss sharing ratio

3 the voting procedures at meetings of partners

4 procedures to be followed in the event of the retirement or death of a partner and procedures to be followed for the admission of a new partner.

The Partnership Act 1895 (WA)

The Partnership Act 1895 (WA) is a law of the Parliament of Western Australia.

The Partnership Act regulates the conduct of partnerships if there is no partnership agreement or if the partnership agreement does not cover one or more of the items set out in the Act.

The Partnership Act provides, for example, that no partner is entitled to a salary for working in the partnership.

If the partners do not want to be bound by the Partnership Act they must have a partnership agreement that overrides the Partnership Act. A partnership agreement, for example, can state that the partners are to be paid an annual salary.

Companies

All businesses operated by sole traders or as a partnership have a significant disadvantage. The owners of the business have unlimited liability for business debts. The personal property of the owners can be sold to pay for the debts of the business. The company form of business structure was created to overcome this disadvantage.

Corporations Act 2001 (Commonwealth)

All aspects of company formation and certain aspects of company operation are controlled by an Act of the Commonwealth Parliament known as the Corporations Act 2001.

Definition of a Company

A company is an organisation established under the Corporations Act 2001 (Commonwealth) as a separate legal entity. A company can make contracts in its own name, can own property and can sue and be sued in its own name.

Capital of a Company

The money or other resources that a person invests in a business is known as capital.

The capital of company is divided into parts known as shares. Each share is given a money value, such as, $1.00 or $2.00. People purchase these shares and become the owners of the company. The owners of a company are known as **shareholders**.

Example

High Technology Proprietary Limited is a company.

The capital of the company consists of 2,000 shares of $1.00 each or a total of $2,000 (2,000 shares x $1.00 per share).

Eric purchased 1,000 shares and Patricia purchased the other 1,000 shares.

A Company Limited by Shares

There are a number of different types of companies. The most common type of company is the company limited by shares.

A company limited by shares is one in which the liability of the shareholders for company debts is limited to the amount owing on their shares.

Example

Jason purchased 1,000 shares in Achieve Proprietary Limited, a company limited by shares. Each share cost $2.00. Jason paid the full $2,000 ($2.00 x 1,000 shares) at the time of purchase. This means that no matter how large the future debts of the company become, Jason cannot be required to contribute any of his own money towards settling these debts.

Proprietary Company

A proprietary company is a company that cannot raise money from the public.

A proprietary company must have at least **1** shareholder and a maximum of **50** non-employee shareholders.

A proprietary company must have the word “Proprietary” or “Pty” included in its name.

Small and Large Proprietary Companies

Proprietary companies can be divided into **small** or **large** proprietary companies.

A **small** proprietary company must satisfy any **two** of the following three conditions:

1 the revenue (such as, sales or fees) for a year is less than $25 million

2 the assets (resources, such as, cash at bank) at the end of a year are less than $12.5 million

3 the company has less than 50 employees at the end of the year.

A **small** proprietary company does not have to prepare an annual financial report (a set of accounting reports that include an income statement and a balance sheet) unless it is directed to do so by shareholders holding 5% or more of the voting shares or by the Australian Securities and Investments Commission. The Australian Securities and Investments Commission is the government authority that regulates companies.

Advantages of a Company Limited by Shares

1 The death of a shareholder does not end the company as it is a separate legal entity.

A company continues to exist until it is closed down by the shareholders or by an order of a court of law or by the Australian Securities and Investments Commission.

2 Shareholders of a company limited by shares have the protection of limited liability.

A shareholder in a company limited by shares is only liable for company debts up to the amount they owe on their shares.

Disadvantages of a Company Limited by Shares

1 A company is subject to much greater regulation than is a sole trader or a partnership.

2 A company is more expensive to form than a sole trader or a partnership.

Comparison of Different Business Entities

Number of Owners

Sole Traders
A sole trader is a business owned by one man or one woman.

Partnerships
A partnership is usually limited to **20** members.

Proprietary Companies
A proprietary company must have at least **1** shareholder and a maximum of **50** non-employee shareholders.

Liability of Owners

Sole Traders
A sole trader is liable for all of the business debts. The personal property of the sole trader can be sold to settle any debts.

Partnerships
Partners are jointly and severally liable for all business debts. If one partner cannot meet his or her share of the business debts the other partners are required to settle these debts.

Proprietary Companies
The liability for debts of shareholders in proprietary companies *limited by shares* is restricted to the amount they owe on their shares.

Transfer of Ownership

Sole Traders
A sole trader can usually transfer the ownership of his or her business without restriction. However, certain occupations, such as, a solicitor, can only be carried on by a suitably qualified person.

Partnerships
Partners cannot retire or transfer their interest in the partnership without the agreement of the other partners.

Proprietary Companies
The constitution of a proprietary company can include a clause that restricts the right of shareholders to transfer their shares to a new owner.

Ability to Raise Capital or Borrow Money

Sole Traders, Partnership and Proprietary Companies

Sole traders, partnerships and proprietary companies have a limited ability to raise capital.

Sole traders, partnerships and proprietary companies are restricted in their ability to borrow money. The extent to which they can borrow money will usually depend on the property (such as, land) that the business owners can offer as security for a loan and the history and current performance of the business.

Distribution of Profits

Sole Traders

The profit belongs to the sole trader. The profit is received by the sole trader as drawings.

Partnerships

The profit is divided between the partners according to the partnership agreement or according to the Partnership Act. The profit is received by the partners as drawings.

Proprietary Companies

The directors of a proprietary company are usually able to approve and pay out a share of the profits to the shareholders in the form of a dividend.

Accounting or Legal Entity

Sole Traders

The business of a sole trader is regarded, in accounting, as being a separate entity from the owner. Business records are kept separate from the personal records of the owner.

Partnership

A partnership business is a separate accounting entity.

Proprietary Companies

A proprietary company is a separate legal and accounting entity.

A proprietary company has its own legal identity. A proprietary company can own property and can enter into contracts in its own name and can sue and be sued in its own name.

The accounting records of a proprietary company are separate from the personal records of the shareholders.

Continuity of Existence

Sole Traders

The death or retirement of a sole trader ends the business.

Partnerships

The death or retirement of a partner ends the partnership unless there is a prior agreement that it will continue.

Proprietary Companies

A proprietary company can have an indefinite life. A change of ownership does not affect the continued existence of the company.

Questions

Question 1

The number of members of a partnership is **usually** limited to:

a 10

b 15

c 20

d 25

Question 2

Amanda and Doug were partners in a business. The business closed down with debts of $30,000. Doug can only contribute $2,000 towards paying off these debts. Amanda has $70,000 in cash in her personal bank account. The amount of money that Amanda will have to pay towards settling the debts of the partnership is:

a $30,000

b $28,000

c $15,000

d $10,000

Question 3

Which of the following is **not** an advantage of a partnership?

a Additional skills

b Greater ability to raise capital

c Limited liability for debts of the business

d Sharing of the workload

Question 4

Emma purchased 1,000 shares of $1.00 each in a proprietary company limited by shares. Emma paid $1,000 for these shares. Emma owns 50% of the share capital of the company. Emma was not involved in the management of the company. The company closed down and owes $8,000 to creditors. Emma's share of this loss is:

a $8,000

b $1,000

c $4,000

d Emma does not have to pay any money towards the debts of the company

Question 5

What is the maximum number of non-employee shareholders that a proprietary company can have?

a 20

b 50

c 100

d 200

Question 6

Which one of these statements is correct?

a A partnership has limited liability.

b A company is a separate legal entity.

c A proprietary company can raise money from the public.

d A public company can have a maximum of 200 shareholders.

Question 7

In the following situation *A* to *E* select an appropriate legal structure for each business. Give a reason for your answer.

Situation A

Adrian wants to establish a home based business that will involve collecting clothes, ironing the clothes and returning the clothes to the customers.

Situation B

Jessica wants to buy a coffee shop for $300,000. Jessica has $140,000 cash in her personal bank account. Jessica has a good friend, Kate, who has experience in operating this type of business. Kate has $200,000 in cash available.

Situation C

Catherine is going to open a DVD rental shop. Catherine wants to ensure that her personal property is not available to creditors should the business fail. Catherine's personal property is valued at $800,000.

Question 7 continued

Situation D

Ken has written a cooking book. Ken is married to Emily who recently resigned from her job and is going to return to full time study at university for the next two years. Ken wants to publish the cooking book himself, rather than using the services of a major publishing house. Emily will manage their publishing business.

Situation E

Peter is considering going into business with his friend, Jake. Peter worked with Jake before in a business. Jake has strong marketing skills but, in the past, tended to be reckless. Jake often made business decisions without consulting Peter. Peter and Jake will each contribute $100,000 to the business. Peter owns a house valued at $500,000 and other personal assets valued at $200,000. Peter would like to protect these assets.

Question 8

Barney Flatstone has been the manager of the Rocktown 10 Pin Bowling Centre for the past five years. Barney has a university degree majoring in accounting and marketing.

Barney has been a successful manager of the bowling centre. Barney has introduced profitable innovations at the centre, such as, special children's bowling birthday parties and disco night bowling sessions. The profits made by the centre, under Barney's management, have increased in each of the last four years. Barney would like to open his own bowling centre but does not have the money.

Fred Pebbles is a customer of the bowling centre. Fred has recently inherited $2,000,000 from a rich uncle who died at the age of 103. Fred would like to own a business but has no business experience and does not have any training in business skills, such as, management, marketing or accounting.

Fred approached Barney and suggested that they form a partnership and open their own 10 pin bowling centre. Fred stated that he was prepared to contribute 90% of the capital required to start the centre (the total capital required is estimated at over $1,000,000). Barney agreed to this proposal.

Required

1. What are the advantages to Fred and Barney of forming a partnership business?

2. Fred believes that if their business had to close down and owed $600,000 to creditors, Fred would only have to pay $300,000 of this debt and Barney would have to pay the remaining $300,000. If Barney didn't have any money the creditors would only receive $300,000. Is Fred correct in this assumption? What form of business structure could better protect the personal assets of Fred?

Question 9

Compare the characteristics of a partnership and a proprietary company limited by shares under the following headings:

a number of owners, and

b continuity of existence.

Question 10

Sam is a shareholder in Advance Pty Ltd. For the year ended 30 June 2019 the revenue (sales) of the company was $32,000,000 and on 30 June 2019 the company had assets (resources, such as, motor vehicles and cash at bank) of $13,000,000.

Required

Is the company a small or a large proprietary company?

? Small Business Survey

This is a group exercise. Select 5 to 10 businesses in the same industry, for example, florist shops or clothing stores, and send each business the following survey questions. Add three or more questions of your own choice to this list.

Question 1

What is the legal structure of your business?

a a sole trader

b a partnership

c a proprietary company

Question 2

How many people are employed full time in your business?

a No employees

b 1 to 5 employees

c 6 to 10 employees

d 11 or more employees

Question 3

My business has been operating for:

a less than 1 year

b between 1 and 3 years

c between 4 and 5 years

d more than 5 years

Make sure that you include a covering letter explaining the purpose of the survey and a stamped, self-addressed envelope. Also include a deadline for the return of the completed survey forms. Present the findings of your survey to the class.