20 Ownership structures

Learning objectives

In this chapter you will learn about:

1. The different forms of business ownership
2. The reasons why a business may change its ownership structure

Sole trader

- A business that is owned and run by one person
- No formalities except registration of a business name
- Small businesses often with family involvement

Benefits

- Easily set up
- Few regulations
- Owner has full control
- Owner receives all profits
- Flexible
- Privacy

Drawbacks

- Heavy pressure and workload on owner
- Owner carries all the risks
- Shortage of capital
- Lack of expertise
- Owner has unlimited liability

Partnership

- A business owned and run by between 2 and 20 people in order to make a profit
- No formalities except registration of a business name
- A partnership agreement, called a Deed of Partnership, may be drawn up
- At least one partner must have unlimited liability for the debts of the business

Benefits

- Easy, quick and cheap to set up
- Workload and risks are shared
- More expertise is available
- More capital is available
- Subject to few regulations

Drawbacks

- Profits must be shared
- Partners have unlimited liability
- Partners may disagree
- The partnership ends if one partner dies

Private limited company

- A business that is owned and controlled by a number of **shareholders** through the purchase of shares in the company
- Can have up to 50 shareholders
- Shareholders have **limited liability** for the debts of the business
- Company is a **separate legal entity** from its owners
- Company can sue and be sued
- Capital is invested in the business through the purchase of shares.
- Major decisions are made at an annual general meeting (AGM)
- One share carries one vote at an AGM
- Shareholders elect a **board of directors** to run the business
- Limited companies are regulated by the **Companies Acts 1963–1999**
- Accounts must be **audited annually** by an accountant

Benefits

- Separate legal entity from the owners/shareholders
- Limited liability encourages shareholders to invest
- More scope to raise capital by issuing shares
- Banks are more willing to lend to limited companies
- Shares can be inherited when a shareholder dies

Drawbacks

- Many formalities and costs in setting up a limited company
- Subject to many laws and regulations
- Annual returns must be sent to the Registrar of Companies
- Shares cannot be sold freely by shareholders

Public limited company

- A public limited company (PLC) is one whose shares can be freely bought and sold by the public on the stock exchange
- At least seven shareholders, with no maximum limit
- PLCs are highly regulated under the law and by the rules of the stock exchange
- Annual returns, including accounts, must be sent to the Registrar of Companies

Benefits

- Can raise finance for expansion through the issue of shares
- Shareholders have limited liability
- High-profile image and publicity
- Good credit status with banks
- Can attract top managers
- Shares or share options can be used to reward and motivate staff
- Shares can be used as a form of payment in the takeover of another firm

Drawbacks

- Company formation costs can be very high
- May be conflict between the shareholders and the board of directors
- Accounts and other information about the firm must be published each year
- PLCs are prone to takeover because the shares may be bought up on the stock exchange

Co-operative societies

A co-operative is a business that is owned and run democratically by at least seven owners who share a common interest, e.g. a producers' co-op involving farmers who all want a market for their milk.

- At least seven members or shareholders
- Application must be made to the Registrar of Friendly Societies to form a co-op
  Accounts and other information must be sent to the Registrar of Friendly Societies each year
- Members put different amounts of capital into the business
- Members have limited liability for the debts of the business
- Decisions made democratically, with each member having one vote regardless of the amount of capital invested
- Management committee is elected by the members to run the business

Benefits

- Members have limited liability
- All members have equal say in running the business
- Co-op can expand by getting new members
- Co-ops have good credit status with banks – can borrow easily

Drawbacks

- Expansion limited to the number of new members the co-op can find
- Co-ops are highly regulated
- Annual accounts and other information must be sent to the Registrar of Friendly Societies
- May be conflict between the interests of the members and the market situation faced by the management committee
- Members of the co-op can find it difficult to sell their shares

State ownership

The government has set up a number of companies, called semi-state bodies or state-sponsored bodies, that are owned, financed and controlled by the state, e.g. Electric Ireland, RTÉ.

- Capital provided by the government
- All borrowings guaranteed by the state
- Board of directors appointed by the government

Top Tip!

You should be able to describe each form of business ownership. You should also be able to make a contrast between any two named forms of business ownership.

Strategic alliance/joint venture

- This is where two or more firms work together to complete a certain project or to develop a product.
- A separate company may be set up to carry out the joint venture or a legal agreement may be signed.

Benefits

- Firms can share costs and risks involved in a project
- Smaller firms can combine to bid for large projects
- Specialist firms can combine with other firms that have different expertise
- Marketing alliances with firms abroad: effective way to sell products to foreign markets

Drawbacks

- Each firm lacks full control over the project
- Serious disagreement can end the project, with loss of money to both firms

Franchises

- Under a franchise, a company that owns an established branded product or service allows another firm to produce and/or sell the product in return for a fee.
- A legal contract is drawn up between the franchiser and the franchisee.
- Strict controls apply to how the franchise is operated.
- The franchiser provides advertising and marketing support to the franchisee.
- The franchisee invests capital in developing the franchise.

Benefits

- Owners of the franchise can expand their business with minimal risk
- Franchiser can retain control over how the product is marketed
- Franchisee can start a new business with a proven record of success
- Consumers benefit from high product standards in outlets worldwide

Drawbacks

- Franchisees limited in what they can do in the business by the franchise agreement
- All units of the business affected by any bad publicity
- Business may lack a personal touch with customers

Top Tip!

Make sure you can explain the differences between strategic alliances and franchises as forms of business organisation.

Changes in ownership structure

Reasons for changing from a sole trader to a partnership business

- To get additional capital from partners
- Workload can be spread out among the partners
- New skills and expertise may come with partners
- Risks shared by the partners

Reasons for changing from a sole trader to a private limited company

- As shareholders, the owners get limited liability for the debts of the business
- Up to 50 shareholders can contribute capital for expansion
- New shareholders bring new expertise to the firm
- Banks more willing to lend to limited companies than sole traders
- A limited company can carry on even if a shareholder dies

Reasons for changing from a co-operative to a public limited company

- PLC can raise unlimited additional capital by issuing new shares
- PLC status improves the image of the firm, both at home and internationally
- Takeovers of other firms can be paid for through the issue of shares
- Original investors in the co-op can sell their shares much more easily

Changing trends in business ownership structures

- Many new private limited companies have been formed by entrepreneurs who want to limit their financial risks in starting a business.
- Fast-growing companies with global potential have moved to become public limited companies to enable them to finance rapid expansion.
- Many new businesses are setting up under franchise arrangements.
- Many strategic alliances are being formed, some between Irish and foreign firms and some public–private partnerships between the government and private companies.
- A number of large agricultural co-operatives have become public limited companies in recent years, e.g. Donegal Creameries plc.
- The government has also sold a number of state-owned businesses into private ownership, e.g. Telecom Éireann and ICC Bank.

Top Tip!

You should be able to discuss the reasons why a business might change from one form of ownership structure to another.

Exam question

1 Describe the steps involved in the formation of a private limited company.
(2011, 20 marks)

Sample answer

Certain documents must be prepared including: Memorandum of Association, Article of Association and Form A1.

Memorandum of Association

- Sets out the relationship between the company and the general public.
- Includes the company name with 'Ltd' and company objectives.
- Shows the signatures of the owners and the authorised share capital.

Articles of Association

- This document sets out the internal rules and regulations of the company.
- It describes the voting procedures for meetings.
- It sets down the quorum necessary for a valid meeting.

Form A1

- Shows company name, and address; lists secretary and directors; statutory declaration; authorised and issued share capital.

The Registrar of Companies examines the documents and issues the company with a Certificate of Incorporation if all is in order. The company is now formed and can start trading.

Marking scheme

- Four steps: 4 x 5 marks name step (2) + development (3) *(5 = 2 + 3)*

Questions

Higher Level long questions

1 Discuss co-operatives and private limited companies as forms of business ownership, using the following headings: formation; liability; finance; control. *(2012, 25 marks)*

2 Outline the reasons why a business may change its organisational structure from a sole trader to a private limited company. *(2010, 20 marks)*

3 Evaluate franchising as a form of business ownership for a new enterprise. *(2009, 20 marks)*

Key-points!

- Compare the different ownership structures
- Distinguish between franchises and strategic alliances
- Know the reasons for changing ownership structure

Key-definitions!

Articles of Association: A document produced as part of the formation of a company. It sets out the internal rules for the running of the firm.

Certificate of Incorporation: This document is proof that a new limited company has been formed. It is issued by the Registrar of Companies.

franchise: When one company pays another company a fee to allow them to set up a business using the other firm's business idea and name, e.g. McDonald's.

limited liability: Means that a shareholder in a limited company can lose only the amount of money the shareholder has invested in the business if the firm gets into financial difficulties.

Memorandum of Association: A document which is produced for the formation of a limited company which gives details of the company name, address, its objectives, its share capital and its shareholders.

private limited company: A form of business ownership where investors buy shares in the company, which becomes a separate legal entity that can sue and be sued.

sole trader: A business that is owned and run by one person.