

Organizations

Chapter 3

Becoming a Legal Entity

- the different ways in which an organisation can become a legal entity;
- the situations for which the different types of legal entity are appropriate;
- what is a limited company is and why it is the preferred legal form for a commercial organisation;
- what is meant by the terms takeover, merger, management buyout and outsourcing;
- the most important ways in which the law regulates limited companies.

Becoming a Legal Entity

- Types of organization: commercial, public, not-for-profit.
- Mostly we look at commercial organizations intended to make profits.
- Different kinds of organization:
 - Sole trader – individual – no legal formalities – the legal entity is the individual.
 - If turnover is big enough will need to register for VAT etc.
 - The individual is liable for company debts – so assets like home, savings are at risk
 - Partnership – this is the form a group must trade under unless it is a limited company
 - Partnership Act 1890 applies
 - Both are jointly responsible for liabilities
 - Another difficulty; changing ownership
 - Often the required form of organization for professionals e.g. law, medical, architecture etc because the liability issues control excesses
 - Liability is joint and several liability – all are fully liable for the debt of the partnership
 - Limited liability partnership; collective responsibility, legal entity unlike partnership
 - Limited company : the preferred form of legal entity for commercial firms

Limited companies

- Three principles:
 - The company is a legal person separate from the people who own or work in the company.
 - Ownership is divided into shares that can be bought and sold by shareholders, some or whole profit is distributed
 - Owners of the company have no obligation to pay debts incurred by the company – the owners risk is limited to the value (money they paid) of their shares.
- In the UK:
 - Public limited company (plc): public can hold shares
 - Private limited company (Ltd): shares cannot be held by the public

Limited companies

- Obligations
 - Must provide details to Companies House (Gov Agency)
 - Annual account and annual reports to be submitted
- Previously limited company could be formed only by either Act of Parliament or Royal Charter
 - Slow and expensive
 - UK parliament developed acts, middle of 19th Century
- Within principles mentioned before, details may vary country to country
- Companies Act 2006
 - 1300 sections

Setting up a company

- Not necessary to employ a lawyer or accountant
- Easiest way is to buy an “off-the-shelf” company and tailor it to your needs (change the name, objectives, constitution, ...)
- Registering a company yourself costs £100 (same-day service at the Registrar of Companies)
 - this is slower because you need to fill in forms etc.
- UK and US have similar, easy, ways to set up companies. In other countries it can take several months and cost thousands of pounds.

Constitution of Limited Company

- Two documents:
 - Memorandum of Association: short and simple – name, location of the registered office, objects of the company, liability clause (saying the limits to liability of the owners), share capital (e.g. 100 shares, value £1 – to be a plc must have capital over £50K). Concludes with declaration of association that list the people setting up the company.
 - Articles of Association: Complex and technical. Covers how the company will run, roles of directors, ...
 - Shareholders agreements
- Once a company is registered then the memo of association and articles of association are on public deposit at Companies House.

Directors

- Sometimes shareholders run the company but in larger companies directors may be employed
- Directors must:
 - Have regard to the owners and employees' interests
 - Act in good faith and for the benefit of the company
 - Exercise skill and care (be “professional”)
 - Declare conflicts of Interest
 - Legally (external obligations):
 - Be aware of the financial position of the company not allow it to continue to incur debts when they know or should have known that the company will be unable to repay them
 - Drawing up annual reports and accounts and filing them at companies house
 - Complies with relevant law
- Companies have executive (employed) and non-executive (non-employed advisors)
- Every company has a company secretary responsible for required communications, public company must have a secretary

Directors

- Directors act in good faith and for the benefit for the company
 - losing a contract
 - required to pay company the compensation
- Directors must exercise the skill and care that is expected from their qualification and experience
 - signed a contract for computers not suitable for company
 - court may order to pay back cost of computer to company
- Director interested to make a contract with a company (cleaning etc) should inform board of directors
 - the model article stipulate the director himself should not be allowed to vote

Conflicts of Interest – Activity

– Reading

- Individually, read clause 14 of the model articles
- In pairs look again at clause 14(4) parts (a)-(c)
- Choose one each of (a) – (c) and try to explain it to your partner
- Write down your explanations.
- Get together in a group of two
- Review your explanations – choose the best one and then work together to write a short scenario describing when you think that clause might be invoked in an imaginary company.

Takeovers

- A being taken over by a larger company B
 - B acquires all shares of A
 - By paying them in Cash
 - Or in its own shares
 - Mixture of both
- Owners as directors, continue to work with new company
- Reasons for selling
 - Convert paper money to real money
 - Need for further capital investment
- A has intellectual property or have high level skills that compliments B
 - A -> automatically carrying out failure mode analysis on electrical car
 - B -> electronic design automation tools

Takeovers

- 1991 SD-Scicon British software house specialized in defense and other hi-tech systems
- EDS -> IT services to large organizations in health services
- EDS takeover SD-Scicon
 - SD-Scicon disappeared – EDS showed no interest in SD-Scicon's traditional market
 - EDS was acquired by Hewlett-Packard for 13.9billion dollars
 - EDS -> player of IT services market
 - EDS retained its identity
 - Breaking EDS would lose purpose
- Strict regulations to stop exploit situation

Takeovers Reasons

- Expanding the customer base
 - A provides services same as B, B to look for customers in different geographical area
- Expanding its range of offerings
 - A offering HR packages, B offers payroll
- Acquiring new staff
- Economies of scale
- Vertical integration
 - strategy where a company expands its business operations into different steps on the same production path
- Eliminating a competitor

Mergers

- New company is formed, which buys the shares of both
- Bell Atlantic and GTE to form Verizon Communications Inc
- Mergers on large scale can effect on competition and public interest
- May subject to examination under monopolies act
- Took 2 years for above mentioned merger to take place

Management buyouts

- Usually require lot capital
- Conflict of interest

Outsourcing

- Conservative party to reduce civil servants and outsource IT services in UK
 - Difficulty of civil service to hire and retain good IT staff
- Arguments for outsourcing
 - Frees management to focus on core business related goals
 - Cost of IT services more visible – easy to control
 - Specialist companies produce effective systems
 - More experience than user companies
 - Justify high qualified/specialists staff
 - Better career path for IT professionals
 - Overall it saves money
- Outsourcing too much may lose control and understanding of their operations

Non Commercial Bodies

Statutory bodies

- In UK 20% public sector – 80% private sector jobs
 - Local government
 - National health service
 - Police
 - Education
 - Armed forces
- Operates on large scale data
 - Department of Work and Pensions holds 50 million people in UK
 - Great need of IT services
 - Employ people directly or other private companies

Non Commercial Bodies

Statutory bodies

- Objectives of private sector
 - Make more and more money
 - Directors run the company
 - Controlled by shareholders
- Objectives of public sector
 - Provide public service
 - Maintain good conditions of roads, providing good education etc
 - Accountability mechanism for management ?

Non Commercial Bodies

Statutory bodies

- Management accountability
 - Accountability through ballot box
 - Members of parliament and local government (councilors) are elected
 - Members of parliament and local government (councilors) are policy makers
 - National government and councilors employ professionals
 - Civil servants
 - Engineers
 - IT staff
 - Tension between politicians and professionals
 - If outsourced, blame is usually put on companies outsourced
 - Politicians – over ambitious goals without getting professional advice

Other non-profit-making bodies

- Other than statutory bodies
 - Professional bodies – BCS
 - Charities – Oxfam – Christian Aid
- Legal status as company limited by guarantee
- Instead of subscribing for shares – in case of liability, members pay small amount each
- Profits not allowed to be distributed to its members
- It can apply for charitable status and grant of royal charter
- BCS incorporated by royal charter and registered charity
- Royal charter states that “government and control of the institute and its affairs shall be vested in the TrusteeBoard”
- BCS being large professional body is run by members and volunteers