22 Forms of business 1

Key points

1. Sole trader, partnership and private limited company.
2. Franchising, social enterprise, lifestyle businesses and online businesses.

Getting started

There are many kinds of business organisation. Some examples include your local hairdresser, Amazon, EasyJet, a window cleaner, Nissan and Oxfam. Who might own these businesses? How are these businesses different? What might be the advantages to a business like Amazon of operating an online business? Do all of these businesses aim to make a profit?

Sole traders

In January 2014, there were around 5 million businesses in the UK. They may vary in their size, ownership and legal structure. A **sole trader** or **sole proprietor** is the simplest form of business organisation. It has one owner, but can employ any number of people. Sole traders can be involved in a wide range of business activity. In the **primary sector**, they may be farmers or fishermen. In the **secondary sector**, they may be small building or manufacturing businesses. However, most sole traders will be found in the **tertiary sector**. Many of these are retailers running small shops. Others may offer services such as web design, tutoring, hairdressing, taxi driving and garden maintenance. Setting up as a sole trader is easy, as there are no legal formalities. However, sole traders do have some legal responsibilities:

- they may have to pay Income Tax and National Insurance contributions
- once their turnover reaches a certain level, they must register for value added tax (VAT)
- they may need a licence to trade if they are involved in activities such as selling alcohol or supplying a taxi service or public transport
- they may need planning permission – for example, a person may have to apply to the local authority for planning permission to convert a warehouse into a nightclub
- they must comply with legislation aimed at business practice – for example, they are legally required to provide safe working conditions for their employees.

However, all sole traders have **unlimited liability**. This means that if the business fails, a sole trader can lose more money than was originally invested. This is because a sole trader can be forced to use personal wealth to pay off business debts. The advantages and disadvantages of operating as a sole trader are summarised in Table 1.

Table 1 Advantages and disadvantages of sole traders

Advantages	Disadvantages
The owner keeps all the profit.	The owner has unlimited liability.
The business is independent and the owner has complete control.	The owner may struggle to raise finance, as lenders may consider them too risky to offer credit.
The business is simple to set up, with no legal requirements.	Independence may be a burden, for example if an owner is ill.
The business can be flexible and can adapt to change quickly.	The owner and any employees are likely to work very hard, with long hours.
The business can offer a personal service because it is small.	The business is usually too small to exploit economies of scale.
The business may qualify for government help.	The business will have no continuity, if the owner passes away.

Partnerships

A **partnership** is defined in The Partnership Act, 1890 as the 'relation which subsists between persons carrying on business with common view to profit'. Put simply, a partnership has more than one owner. The 'joint' owners will share responsibility for running the business and also share the profits. Partnerships are often found in professions such as accountants, doctors, estate agents, solicitors and veterinary surgeons. After sole traders, partnerships are the most common type of business organisation. It is usual for partners to specialise. A firm of chartered accountants with five partners might be organised so that each partner specialises in one aspect of finance, such as tax law, investments or VAT returns.

There are no legal formalities to complete when a partnership is formed. However, partners may draw up a DEED OF PARTNERSHIP. This is a legal document which states partners' rights in the event of a dispute. It covers issues such as:

- how much capital each partner will contribute;
- how profits (and losses) will be shared amongst the partners;
- the procedure for ending the partnership;
- how much control each partner has;
- rules for taking on new partners.

If no deed of partnership is drawn up the arrangements between partners will be subject to the Partnership Act. For example, if there is a dispute regarding the share of profits, the Act states that profits are shared equally among the partners.

The advantages and disadvantages of partnerships are shown in Table 2.

Table 2 Advantages and disadvantages of partnerships

Advantages	Disadvantages
The partnership is easy to set up and run, with no legal formalities.	Partners have unlimited liability.
Partners can specialise in their area of expertise.	Partners have to share the profit.
Partners share the burden of running the business.	Partners may disagree and fall out with one another.
More owners can raise more capital.	One partner's decision is legally binding on all other partners.
The partnership does not have to publish financial information.	Partnerships have limited growth potential.

Limited partnerships

The Limited Partnerships Act 1907 allows a business to become a LIMITED PARTNERSHIP, although this is rare. This is where some partners provide capital but take no part in the management of the business. Such a partner will have LIMITED LIABILITY - the partner can only lose the original amount of money invested. A partner with limited liabillity cannot be made to sell personal possessions to meet any other business debts. This type of partner is called a **sleeping partner**. Even with a limited partnership there must always be at least one partner with **unlimited liability**. The Act also allows this type of partnership to have more than 20 partners.

The Limited Liability Partnership Act, 2000 allows the setting up of a limited liability partnership. All partners in this type of partnership have limited liability. To set up as a limited liability partnership, the business has to agree to comply with a number of regulations, such as filing annual reports with the Registrar of Companies.

Question 1

Jones, Thomas and Wilson is a firm of chartered accountants based in Aylesbury. The partnership was formed in 2009, when each of the partners contributed £50,000 in capital. A Deed of Partnership was drawn up and it was agreed that the profits from the business would be shared 40 per cent, 40 per cent and 20 per cent between Jones, Thomas and Wilson respectively. Wilson's share was lower because he was a newly qualified accountant and therefore had less experience than the others.

One of the business's strengths is that each partner is a specialist in a particular field of accountancy. Jones is a tax specialist, Thomas is an investment analyst and Wilson is in charge of external audits. This helped the business to serve a range of customers with different financial needs.

In 2011, the partners decided to expand. They needed to raise £100,000 to obtain more office space and upgrade their computer systems. The partners considered inviting a sleeping partner to contribute some capital. However, in the end, they borrowed the money from a bank.

(a) (i) Why do you think Jones, Thomas and Wilson drew up a Deed of Partnership?

(ii) In 2013, the partnership made a profit of £240,000. In the absence of a Deed of Partnership, how much profit would Wilson be entitled to?

(b) Explain two advantages of a partnership illustrated by this case.

(c) Discuss two possible reasons why Jones, Thomas and Wilson decided against inviting a sleeping partner into the business.

Limited companies

A **limited company** is a separate legal identity from its owners. The company can own assets, form contracts, employ people, sue people and be sued.

Certain features are common to limited companies.

- Capital is raised by selling shares. Each shareholder owns a number of these shares and is a joint owner of the company. They are entitled to vote on important business decisions, such as a choice of who should run the company. They also get dividends paid from profits. Shareholders with more shares will have more control and get more dividends.
- Unlike sole traders or partnerships, the owners (shareholders) have limited liability. If a limited company has debts, the owners can only lose the money they originally invested. They cannot be forced to use their own money to pay any debts that have been run up by the business.
- Limited companies are run by directors who are elected by the shareholders. The board of directors, headed by a chairperson, is accountable to shareholders. The board runs the company as the shareholders wish. If the company performs badly, directors can be voted out at an annual general meeting (AGM).
- Unlike sole traders and partnerships, who pay Income Tax on profits, limited companies pay Corporation Tax.

Forming a limited company

To form a limited company, it is necessary to follow a legal procedure. This involves sending some important documents to the Registrar of Companies. These are the **Memorandum of Association** and the **Articles of Association**. These are shown in Figures 1 and 2.

Figure 1

Memorandum of Association

The Memorandum of Association sets out the constitution and gives details about the company. The following details must be included:
- name of the company
- name and address of the company's registered office
- objectives of the company and the nature of its activities
- amount of capital to be raised and the number of shares to be issued.

Figure 2

Articles of Association

This document deals with the internal running of the company. The Articles of Association include details such as:

- rights of shareholders depending on the type of share they hold
- procedures for appointing directors
- length of time directors should serve before re-election
- timing and frequency of company meetings
- arrangements for auditing company accounts.

If the documents in Figures 1 and 2 are acceptable, the company gets a **Certificate of Incorporation**. This allows it to trade as a limited company. The shareholders have a legal right to attend the AGM and must be told of the date and venue in writing.

A limited company can be set up online, and a number of websites offer such services. Such websites provide templates for the Memorandum of Association and the Articles of Association, which makes the whole process easier.

Private limited companies

Most private limited companies are small or medium-sized business, though some are large businesses, similar in size to public limited companies. Private limited companies share the following features.

- Their business name ends in Limited or Ltd.
- Shares can only be transferred privately, from one individual to another. All shareholders must agree on the transfer and they cannot be advertised for sale.
- They are often family businesses owned by family members or close friends.
- The directors of private limited companies tend to be shareholders and are involved in running the business.

Table 3 Advantages and disadvantages of private limited companies

Advantages	Disadvantages
Shareholders have limited liability.	Private limited companies have to publish their financial information.
More capital can be raised by issuing shares.	Setting up costs have to be met.
Control over the business cannot be lost to outsiders.	Profits are shared between more members.
The owners have tax advantages. Owners may pay less tax, for example.	It takes time to transfer shares to new owners.
Private limited companies are considered to have a higher status than some other types of business organisations, such as a sole trader.	Private limited companies cannot raise large amounts of money like public limited companies.

Question 2

Ilene Bracken owns VegPack, a food processing business in Wigan. The business supplies small retail outlets in the north-west region of the UK with pre-packed vegetables. She buys vegetables in bulk from local farmers and then washes, trims and packs them attractively before dispatching them to customers. She set up as a sole trader in 2006, but the growth of the business has taken her by surprise. The success is down to a 'sale-or-return' policy that customers like. This results in some waste, but her premium pricing helps to compensate for any losses.

In order to meet the demands of rapid growth and to help expand into new markets, Ilene needs to raise £400,000. She has approached a number of banks, but has found that they are reluctant to lend to her. Her accountant has suggested forming a private limited company to raise money by issuing some shares to members of her family and two key employees of the business.

(a) Explain two advantages of becoming a shareholder in VegPack.

(b) Explain who runs a private limited company.

(c) Assess the likely impact on Ilene of VegPack becoming a private limited company.

Starting up your own business carries a lot of risk. Most new start-ups have ceased to exist after five years of trading. One way of possibly reducing this risk is to buy a FRANCHISE. The franchisor is a company which owns the franchise. It has a track record of running a successful business operation. It allows another business, the franchisee, to use its business ideas and methods in return for a variety of fees. In the UK, there are a large number of franchise operations including Dairy Crest, Domino's Pizza, Dyno-Rod, McDonald's, Subway and Tumble Tots.

The franchisor provides a variety of services to its franchisees.

- Its gives the franchisee a licence to make a product which is already tried and tested in the market place. This could be a physical product but is far more likely to be a service.
- The franchisor provides a recognised brand name which customers should recognise and trust. This helps generate sales from the moment the franchise starts trading.
- The franchisor will provide a start-up package. This will include help and advice about setting up the business. The franchisor might provide the equipment to start the business. It might help find a bank which will lend money. It will provide training for the new franchisee.
- Many franchises provide materials to use to make the product. A company like McDonald's, for examples, sells food ingredients to its franchisees. If the franchisor doesn't directly sell to the franchisee, it might organise bulk-buy deals with suppliers to cut costs for all its franchise operation.
- It is likely to provide marketing support. For example, it might have national advertising campaigns. It may provide marketing materials like posters to place in business premises or leaflets to circulate to customers.

- There should be ongoing training. This will be linked to issues such as maintaining standards, sales and new products.
- There is likely to be a range of business services available at competitive prices. For example, the franchisor might negotiate good deals on business insurance or vehicle leasing with suppliers.
- Many franchises operate exclusive area contracts. This is where one franchisee is guaranteed that no franchise deal will be signed with another franchisee to operate in a particular geographical area. This prevents competition between franchisees and so helps sales.
- Over time, the brand should be developed by the franchisor. For example, new products should be developed to appeal to customers.

In return for these services, the franchisee has to pay a variety of fees.

- There will be an initial start-up fee. Part of this will cover the costs of the franchisor in giving advice or perhaps providing equipment. Part of it will be a payment to use the franchise name.
- Most franchisors charge a percentage of sales for ongoing management services and the ongoing right to use the brand name.
- Franchisors will also make profit on the supplies they sell directly to their franchisors.
- There may also be one-off fees charged for management services such as training.

The advantages and disadvantages to franchisors and franchisees are shown in Tables 4 and 5.

Table 4 Advantages and disadvantages to franchisees of franchising

Advantages to the franchisee	Disadvantages to the franchisee
Franchises are lower risk, as they use an idea that has already been tried and tested.	A franchisee's profit is shared with the franchisor.
Franchisees get support from the franchisor.	Franchisees have to sign contracts with franchisors, which can reduce independence.
The set-up costs of a franchise are predictable.	Setting up a franchise can be an expensive way to start a business.
Franchisees can benefit from national marketing campaigns organised by the franchisor.	Franchisees lack independence and must abide by strict operating rules.

Table 5 Advantages and disadvantages to franchisors of franchising

Advantages to the franchisor	Disadvantages to the franchisor
Franchising is a fast method of growth.	Potential profit is shared with franchisees.
Franchising is a cheaper method of growth because franchisees take some of the financial risk.	Poor franchisees may damage the brand's reputation.
Franchisees take some of the risk on behalf of the franchisor.	Franchisees may get their merchandise from elsewhere.
Franchisees are more motivated than employees.	The cost of supporting franchisees may be high.

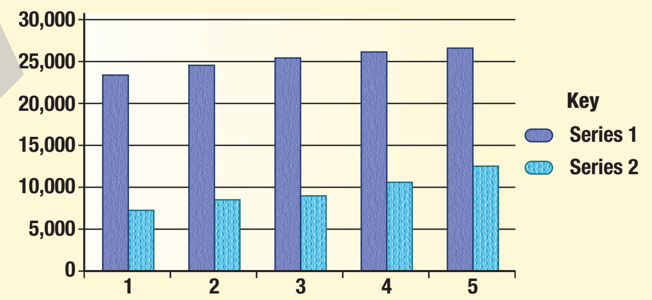
Question 3

SUBWAY® is an international franchise operation selling sandwiches and other snacks. Their outlets offer a fresh, healthy alternative to fast-food restaurants. The success of the US-based franchise is due partly to the support that it offers to its franchisees, including:

- **Training:** Franchisees must attend a two-week training course and they have access to an online training programme provided by SUBWAY.
- **Franchisee** organisations and involvement: SUBWAY supports franchisees and tries to involve them in decision making.
- **Purchasing company:** SUBWAY has a specialist company that manages the purchase and supply of all food, packaging, equipment and services to franchisees.
- **Two-way communication:** Franchisees are encouraged to share best practice with support service providers, exchange ideas and develop an understanding of each other's needs and objectives.
- **Brand strength:** The SUBWAY brand is recognised worldwide and franchisees are encouraged to get involved in its marketing. In the UK and Ireland, 4.5 per cent of gross sales is paid into an advertising fund.

Figure 1

Growth in SUBWAY franchise outlets between 2010 and 2014



Source: adapted from www.entrepreneur.com/franchises/subway/282839-0.html / and www.subway.co.uk.

(a) Explain the difference between a franchisor and a franchisee.

(b) Discuss the key benefits to franchisees of taking out a SUBWAY franchise.

(c) How does the data in Figure 3 illustrate one of the key advantages to the franchisor of franchising?

Social enterprises

Some businesses operate as social enterprises. These organisations trade with the aim of improving human and environmental well-being, rather than making profit for external owners. They are sometimes referred to as not-for-profit organisations. Generally, social enterprises:

- have a clear social and/or environmental mission
- generate most of their income through trade or donations
- reinvest most of their profits
- are not connected to the government
- are majority controlled in the interests of the social mission
- are accountable and transparent.

Social enterprises may take a variety of forms.

Co-operatives: Most modern **co-operatives** operate as consumer or retail co-operatives. They are owned and controlled by their members. Members can purchase shares that entitle them to a vote at annual general meetings (AGMs). The members elect a board of directors to make overall business decisions and appoint managers to run day-to-day business. Co-operatives are run in the interests of their members. Any surplus made by the co-operative is distributed to members as a dividend according to levels of spending.

Worker co-operatives: These are businesses jointly owned by their employees. Examples might be a wine growing co-operative or a co-operative of farmers producing milk. In a worker co-operative, employees are likely to:

- contribute to production and be involved in decision making
- share in the profit (usually on an equal basis)
- provide some capital when buying a share in the business.

Mutual organisations: Most building societies in the UK are **mutual organisations**. They are owned by their customers – or members, as they are known – rather than by shareholders. They offer a wide range of financial services such as mortgages and savings products. Profits are returned to members in the form of better and cheaper products**.** Friendly societies (also mutual organisations) began in the 18th and 19th centuries to support the working classes. Today, they offer a wide range of affordable financial services. These include savings schemes, insurance plans and protection against the loss of income or death.

Charities: These exist to raise money for various causes and draw attention to the needs of disadvantaged groups in society. For example, Age UK is a charity that raises money on behalf of older people. They also raise awareness of issues that relate to older people, such as the winter fuel payment. Other examples of charities include the British Red Cross, Save the Children Fund and Mencap. Charities rely on donations for their revenue. They may also organise fundraising events such as jumble sales, sponsored activities and raffles. A number of charities also run business ventures such as charity shops.

Lifestyle businesses

A person running a **lifestyle business** aims to make enough money and provide the flexibility needed to sustain a particular lifestyle. The business should be lucrative enough to support the desired lifestyle without having to sacrifice time for the entrepreneur's personal life. Typical examples might include tradespeople such as plumbers and electricians, consultants in a variety of industries, florists, and people who run small retail stores, bed and breakfasts and small lifestyle farms. Many online businesses, such as web design, coaching, advisory or marketing services, also operate as lifestyle businesses. Some features of lifestyle businesses are as follows.

- The business will often be small and is likely to have just one owner.
- The personal interests of the entrepreneur are likely to influence the nature of the business, so that time spent working is enjoyable.
- An owner may undertake a variety of different ventures. For example, a musician may generate income by playing live in a band, teaching people to play an instrument, busking, teaching part-time in a college and writing music for adverts.
- Running the business is likely to be much less stressful than other forms of business.
- The business is likely to be home-based.
- They are likely to have similar advantages and disadvantages to those of sole traders.
- Lifestyle businesses are sometimes considered an alternative to retirement.

Lifestyle businesses are sometimes contrasted with start-up businesses, which are intended to grow and create increasing amounts of profit. Because growth in revenue and profit is not a key objective to lifestyle businesses, owners of lifestyle businesses usually have to provide all the funding themselves. Not many external investors will fund businesses that do not aim to maximise profits. However, there are exceptions. For example, Tim Ferriss runs a large lifestyle business in the US. He is an author, business advisor and angel investor, and in 2014 he was ranked sixth in the Top 20 Angel Investor rankings.

Online businesses

Amazon.com, Moneysupermarket.com, Confused.com, eBay and Facebook are examples of large and well-known **online businesses**. However, there are many thousands of much smaller examples including retailers, consultants, gaming companies, bloggers, share dealers, teachers, web designers and information providers. Despite being very different companies, they all use the internet to trade and are likely to have the following features in common.

- Customers access the business via the internet. All online businesses have a website which gives information about their products, their prices and general information about the company.
- Online businesses collect payment for goods and services electronically. Credit cards, debit cards and PayPal are the most common methods used.
- There are no formal procedures to follow or legal requirements when starting an online business. However, traders must have secure web sites with adequate protection against technical breakdowns and fraud.
- Online businesses have low set-up costs. A trader could build their own website for a few hundred pounds. Alternatively, for a higher set-up cost, a new online trader could purchase a complete set-up package, including web design, domain name registration and arranging the hosting of the website by an internet service provider. Many online businesses are also run from home, which eliminates the need to find business premises.
- For many online businesses, paid-for or sponsored advertising is their main source of revenue. For example, most people use Facebook's social media services free of charge. However, in 2013, most of the $7.87 billion revenue was generated from advertising on the site.

The majority of businesses have websites that give information about company history, products, services, company aims and contact details. Also, many retailers, such as supermarkets, chain stores and even independent retailers, have an online sales operation.

The internet has fundamentally changed the way products and services are sold. It has also revolutionised the development, design, production and distribution of products and services. Thanks to the internet, even small businesses have access to global markets, international suppliers and foreign employees. By 2016, the internet is forecast to grow 12.4 per cent in the UK, contributing some £225 billion to the economy. This is not surprising if you look at the growth in global internet usage shown in Table 6.

Source: adapted from www.theguardian.com/technology/2013/mar/01/tech-companies-uk-economy

Table 6 Growth in global internet users from 2005 to 2014

Year	Number of internet users worldwide
2005	1,023 million
2010	2,032 million
2014	2, 923 million*

*Estimate
Source: Adapted from www.itu.int/

Maths tip

When analysing data like that shown in Table 6, it may be useful to describe changes over time in percentage terms. For example, internet use rose from 1,023 million in 2005 to 2,032 million in 2010. The percentage increase is calculated as follows:

$$\frac{\text{Difference}}{\text{Original number}} \times 100 = \frac{2{,}032\text{ m} - 1{,}023\text{ m}}{1{,}023\text{ m}} = \frac{1{,}009\text{ m}}{1{,}023\text{ m}} \times 100 = 98.6\%$$

Therefore you could say that internet usage rose by 98.6 per cent between 2005 and 2010.

Case study

KHAN ACADEMY

Khan Academy is an example of both a social enterprise and an online business. It is a not-for-profit business that aims to change education for the better by providing a free world-class education for anyone anywhere. In 2014, the organisation employed around 80 people and had around 10 million users each month. All of the site's resources are available to anyone who has an internet connection – there are no subscription fees or other charges. Its services are aimed at students of all ages, teachers and parents.

- The website offers support such as practice exercises and instructional videos. It also provides some teacher aids and is designed to let learners work at their own speed.
- Resources are adjusted to meet individual needs. They offer personalised advice about the order of learning and help to motivate learners.
- More than half the students are from the US but students from countries like India, Brazil, Mexico, South Africa and beyond, also use the site. Video lessons have been translated into 28 languages to meet the needs of these international students.
- Learning programmes address many subjects such as maths, physics, biology, economics, art history and computer science.
- Most revenue is raised from donations. For example, in November 2011, Khan Academy received a grant of $5 million from the O'Sullivan Foundation.

Source: adapted from www.khanacademy.org.

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(a) What is meant by a social enterprise? (2 marks)

(b) Explain one benefit to Khan Academy of operating an online business. (4 marks)

(c) Assess the importance of growth in Internet usage on an online business like Khan Academy. (12 marks)

Key terms

Articles of Association – a document that provides details of the internal running of a limited company.
Certificate of Incorporation – a document that declares a business is allowed to trade as a limited company.
Deed of Partnership – a binding legal document that states the formal rights of partners.
Franchise – a business model in which a business (the franchisor) allows another operator (the franchisee) to trade under their name.
Lifestyle business – a business that aims to make enough money and provide the flexibility needed to support a particular lifestyle for the owner.
Limited liability – a legal status which means that a business owner is only liable for the original amount of money invested in the business.
Limited company – a business organisation that has a separate legal entity from that of its owners.
Limited partnership – a partnership where some members contribute capital and enjoy a share of profit, but do not participate in the running of the business. At least one partner must have unlimited liability.
Memorandum of Association – a document that sets out the constitution and states key external details about a limited company.
Online business – a business that uses the global communications infrastructure of the Internet as a trading base.
Partnership – a business organisation that is usually owned by between 2-20 people.
Primary sector – production involving the extraction of raw materials from the earth.
Private sector – businesses that are owned by individuals or groups of individuals.
Secondary sector – production involving the conversion of raw materials into finished and semi-finished goods.
Sleeping partner – a partner that contributes capital and enjoys a share of the profit but takes no active role in running the business.
Social enterprise – a business that trades with the objective of improving human or environmental well-being – charities and workers' co-operatives for example.
Sole trader or sole proprietor – a business organisation which has a single owner.
Tertiary sector – the production of services in the economy.
Unlimited liability – a legal status which means that the owner of a business is personally liable for all business debts.

Knowledge check

1. State three advantages and three disadvantages of being a sole trader.
2. What is the advantage of a deed of partnership?
3. State three advantages and three disadvantages of partnerships.
4. What is meant by a sleeping partner?
5. What is the role of directors in limited companies?
6. What is the difference between the Memorandum of Association and the Articles of Association?
7. State two disadvantages of private limited companies.
8. Give two examples of a social enterprise.
9. State three features of a lifestyle business.
10. State two advantages of online businesses.