Chapter 14

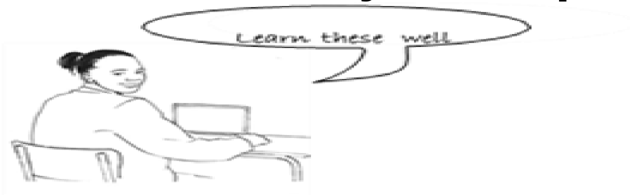
Forms of Ownership

Introduction:
Forms of ownership refer to the type of business a business owner wants to register and start. Various factors need to be considered before deciding on the form of ownership as they may have an impact on the success or failure of a business.

Overview

TOPIC	CONTENT	CONTENT DETAILS FOR TEACHING, LEARNING AND ASSESSMENT PURPOSES
14. **Forms of Ownership** 	• Characteristics of various of forms of ownership • Advantages and disadvantages of • Contribution of the forms of ownership to the success/failure of the business in terms of the following criteria: Capacity Tax implications. Management: Capital: Division of profits Legislation/Legal requirements • Impact of the different forms of ownership on business success/failure	• Evaluate the contribution of the forms of ownership to the success/failure of the business in terms of the following criteria: ***Capacity***: Refers to the ability/potential of management to start and operate a business as planned. ***Tax implications***: The tax requirements of each form of ownership determine the impact of taxation on business success/ failure. ***Management***: Ownership impacts on management functions which determine the success/failure of the business. ***Capital***: Refers to the ability to obtain capital from various sources (e.g. own/borrowed capital). The amount of capital that can be success/failure. ***Division of profits***: Refers to how profit is divided between owner(s)/shareholders/ investors. ***Legislation/Legal requirements*** for establishment/starting a business impact on the establishment costs and time before a business can legally do business. • Evaluate the impact (positives/advantages and/or negatives/disadvantages) of the different forms of ownership on business success/failure.

14.1 Key concepts



These definitions will help you understand the meaning of key Business Studies concepts that are used in this chapter

Term	Definition
Form of ownership	The legal position of the business and the way it is owned.
Continuity	Continue to exist even if a change of ownership takes place, e.g a member or shareholder dies or retires.
Surety	If a person or business accepts liability for the debt of another person or business.
Securities	Shares and bonds issued by a company.
Limited liability	Loses are limited to the amount that the owner invested in the business.
Unlimited liability	The owner's personal assets may be seized to pay for the debts of the business.
Memorandum of Incorporation (MOI)	The document that sets out the rights, responsibilities and duties of shareholders and directors.(serves as a constitution of a company).
Sole Trader /Sole proprietor	A business is owned and controlled by one person who takes all the decisions, responsibility and profits from the business they run.
Partnership	An agreement between two or more parties that have agreed to finance and work together in the pursuit of common business goals.
Co-operative society	Autonomous association of persons united voluntarily to meet their common economic/ social needs/aspirations through a jointly owned and democratically controlled enterprise.
Company	A company is a legal person who has capacity and powers to act on its own.
Profit Companies	A company incorporated for the purpose of financial gain for its shareholders.
Non-profit company	A non-profit company is an association incorporated not for gain.
Public company	A public company is a voluntary association of ONE or more persons, governed by the company Act 71 of 2008, incorporated in terms of the Memorandum of Incorporation.
Private company	A private company is a voluntary association of 1 or more persons.
Personal liability company	A personal liability company is a voluntary association of 1 or more person.
State-Owned company	A state-owned company (SOC) is a legal entity that is created by the government in order to participate in commercial activities on its behalf.
Partnership Article	A document that contains exhaustive provisions with regards to the matters concerning the business and the partners.
Prospectus	Prospectus is a document inviting the public to buy securities/shares.
Annual General Meeting (AGM)	A meeting held once a year where the shareholders receive a report stating how well the company has done.
Directors	People elected to the board of a company by the shareholders to represent the shareholders' interests.

14.2 Characteristics, advantages and disadvantages of forms of ownership

Forms of ownership	Characteristics	Advantages	Disadvantages
Sole proprietor	• A sole trader is a business that is owned and managed by one person. • A sole trader has limited company for expansion and lacks continuity of existence. • Responsible for all the financial/ management decision.	• Easy to control since it is a small business. • One owner so there is no disagreements. • Can make quick decisions without having to consult others.	• Difficult to continue and grow long term. • Owners has to rely on own decisions and could make incorrect ones. • If profits get too big may end up paying high tax in personal capacity.
Partnership	• There is no limitation on numbers of partners. • The partnership does not pay income tax, only the partners in their personal capacities. • Jointly liable for legal/financial/ethical problems.	• Partners are actively involved in. management and may use the ideas of other partners. • Not all partners need to be actively involved in management and would rather appoint competent managers. • Easy and expensive to establish/partners must draw up partnership agreement.	• Decision making can be time consuming as all partners have to be in agreement. • Some management tasks may be neglected, as one partner may leave it to others to complete. • Partners may disagree on how to run the business, which may lead to tension between them.
Private company	• The company name ends in (PTY) Ltd. • Public cannot buy shares in a private company • Limited liability, jointly shareholders and is a separate legal entity.	• Can obtain tax rebates if they are involved in SCI projects. • Capital can be increased by getting more shareholders. • The company and its owners (shareholders) are separate entities, which may encourage more people to join the company.	• Shares are not freely transferable, so less capital can be raised. • If the company fails to attract financially strong shareholders, it may hamper its growth opportunities. • Directors may not have a direct interest in the company, which can hamper growth and profit maximisation.
Public company	• Requires three or more directors and one or more shareholders. • The name ends with Ltd. • Public can buy shares in company.	• The business has its own legal identity. • Easy to raise funds for growth through the sale of shares. • Can appoint a knowledgeable board of directors. • It is easy to buy and sell shares.	• Large capacity of the company can also lead to its downfall in that structure. • Large structure can result in decision making taking time. become too costly. • Subject to double taxation e.g. shareholders pay secondary tax this can have a negative impact to a company that is already financially struggling.

State owned company	• The company name ends with SOC. • Profits are distributed to all sectors. • Offer essential services which may not be offered by the private sector. • Requires three or more directors and one or more shareholders.	• Profits are distributed to all sectors. • Profits may be used to finance other state departments/reduce taxes. • Offer essential services which may not be offered by the private sector.	• May result to poor management as government is not always as efficient as the private sector. • A lack of incentive for employees to perform if there is no share in the profit. • Often rely on government subsidies.

NB

The characteristics, advantages and disadvantages of a private company are the same as a personal liability company except the following:

- The directors of a personal liability company are jointly and severally liable for the debts of the business.
- The name of a personal liability company ends with PLC.

ACTIVITY 1

1.1.1 This form of ownership can trade its shares on the Johannesburg Securities Exchange.
- A Sparks (Pty) Ltd
- B Nalini and Daughters Attorneys
- C Kimbelin Diamonds Ltd
- D Kia Motors CC

1.1.2 Unlimited liability means …
- A Owner's personal assets are protected in the event that the business becomes insolvent.
- B owners stand to lose their personal assets in the event that the business becomes insolvent
- C owners cannot lose more than what they have invested in the business in the event that the business becomes insolvent
- D owners are not entitled to share in the profits of the business

1.1.3 A partnership has ……
- A limited liability and limited continuity
- B limited liability and unlimited continuity
- C limited liability and limited continuity
- D unlimited liability and unlimited continuity

1.1.4 This company must first register the Memorandum of Incorporation before commence.
- A State owned
- B Close Cooperation
- C Partnership
- D Sole proprietor

1.2 Name the form of ownership represented by each of the following statements.

1.2.1 Past and current directors are jointly and severally liable for the debts of this company.
1.2.2 This business is owned by two or more people who pay tax in their personal capacity.
1.2.3 The government is the only shareholder in this company.
1.2.4 This form of ownership can no longer be registered but it is still in existence.
1.2.5 Themba (PTY) Ltd may not invite the public to buy shares. . (10)

Answers to the activity 1

1.1.1 C√√
1.1.2 B√√
1.1.3 D√√
1.1.4 A√√ **(8)**

1.2.1 Personal Liability company √√
1.2.2 Partnership√√
1.2.3 State owned company √√
1.2.4 Close Corporation √√
1.2.5 Private company √√
(10)

14.3 FACTORS THAT CONTRIBUTES TO THE SUCCESS AND FAILURE OF THEFORM OF OWNERSHIP

CRITERIA	SUCCESS FACTORS	FAILURE FACTORS
	PARTNERSHIP	
Capacity	• Simple to establish a partnership entity. • Encourages expansion as more partners join the business.	• In large partnership, the partners may struggle to agree on business issues. • The more partners in the partnership, the more difficult it is to control expenses and partners' drawings.
Management	• Partners are actively involved in management and may use the ideas of other partners. • Not all partners need to be actively involved in management and would rather appoint competent managers. • Partners have access to expertise of other partners when tough decisions have to be made.	• Decision making can be time- consuming as all partners have to be in agreement. • Some management tasks may be neglected, as one partner may leave it to others to complete. • Partners may disagree on how to run the business, which may lead to tension between them. • Partners are agents of the partnership and bad management decisions may be forced onto other partners.
Capital	• Partnerships can be financially strong because many partners contribute. • Smooth cash flow as there is enough working capital.	• Partners may lose their capital contribution if the business fails. • Partners don't contribute skills which might be unfair to partners who also have skills. • Partners may not all have capital to put into business when needed. • Unequal inputs as some partners put in expertise instead of cash.
Legislation	• Easy and expensive to establish/partners must draw up partnership agreement. • Partnerships may apply for local tenders. • Partners are more motivated to make a success because their personal possessions are at risk.	• An oral agreement may create problems for partners in future which can affect its success. • Partners are jointly and severally liable for business debts. • Unlimited liability/ partners are jointly and severally liable for the debts of the business. • If one partner dies or retires, the remaining partners need to draw up a new agreement.
Taxation	• Partnerships pay VAT only on relevant products sold/services rendered which reduces tax administration. • The partnership does not pay income tax, only the partners in their personal capacities.	• Failure to comply with tax regulations by one or more partners may lead to business closure. • Individual tax paid by partners on income earned is higher than fixed tax rate percentage paid by companies/close corporations. • High-earning partners pay more tax, which may discourage other partners from joining the partnership. • Partners may withdraw more cash to reduce their tax burden which may cause cash flow problems for the partnership.
Division of	• Partners share profits according to their contributions.	• Amount of work done may not be equal to the amount of profit that

profits		each partner receives.
PUBLIC COMPANY		
Capacity	• Can raise large amounts of capital as shares/ debentures can be sold to the public/shareholders. • Share capital clause in the Memorandum of Incorporation (MOI) may be changed to issue more shares. • May attract financially strong investors if share value increases/remain stable.	• Very costly to maintain infrastructure and large employee base. • Large amounts of capital required to start a public company. • Large capacity of the company can also lead to its downfall in that structures and processes may become too costly.
Management	• Management is in the capable hands of a board of directors who have skills/knowledge/ abilities. • Shareholders can vote for/appoint the most capable directors to manage their company.	• Directors may not have a direct interest in the company, which can hamper growth and profit maximisation. • Large management structure can result in decision making taking time. • Directors' fees increase the company's expenses which reduces net profit. • Management may open to legal challenges if their reports do not comply with King Code 111.
Capital	• Can raise large amounts of capital as shares/ debentures can be sold to the public/shareholders. • Amount of shares available can be increased to raise capital.	• Shareholders are entitled to see a company's financial statements which impacts on the privacy of the company. • Growth is limited if sufficient capital cannot be raised. • Share prices change all the time and can lose their value.
Legislation	• The company and its owners (shareholders) are separate entities, which may encourage more people to join the company. • Limited liability allows for greater risk taking, which may lead to growth of the business. • Auditing of financial statements, gives shareholders the assurance that the business is being properly managed.	• Formation procedures are time consuming/complicated/ expensive, as many legal documents need to be prepared/submitted. • High formation/establishment expenses require large start-up capital. • Annual audit of financial statements is costly. • If a public company does not comply with legislation, its licence maybe withdrawn by the Companies and Intellectual Property Registration Office (CIPRO)/Companies and Intellectual Property Commission (CIPC.
Taxation	• Can obtain tax rebates if they are involved in SCI projects. • Can obtain government tenders and renew their licenses if they do not evade tax.	• Subject to double taxation e.g. shareholders pay secondary tax this can have a negative impact to a company that is already financially struggling.
Division of profits	• Profits could be split between company and shareholders. • Shareholders receive return on investment, when dividends are paid out according to the type and number of shares held in the company. • Large profits may be used for expansion/kept in a	• Dividends are not always paid out which may discourage new investors. • Subject to double taxation e.g. shareholders pay secondary tax this can have a negative impact to a company that is already financially struggling.

	reserve fund for future growth.	
	PRIVATE COMPANY	
Capacity	• Large amount of capital can be raised since there is no limit on the number of shareholders. • The company can access long term capital and therefore has good long term growth opportunities.	• It cannot grow into a very large business since it cannot invite the public to buy shares. • Restrictions on transferability of shares may discourage people from joining the company. • If the company fails to attract financially strong shareholders, it may hamper its growth opportunities.
Management	• Management is in the capable hands of a board of directors who have skills, knowledge and abilities. • Shareholders can vote for/appoint the most capable directors to manage their company.	• Shareholders have the power to elect suitable directors, but not all shareholders exercise their voting rights. • Directors may sometimes act in their own best interests, not in the company's best interests.
Capital	• Even though shares are not freely transferable, large private companies can raise considerable amount of capital.	• Large amount of capital cannot be obtained because capital contribution is only limited to private shareholders.
Legislation	• Procedures to form a private company have been simplified by the new Companies Act 71 of 2008. • Limited liability allows for greater risk taking, which may lead to growth of the business. • Auditing of financial statements (if required), gives shareholders the assurance that the business is being properly managed and supports raising additional finance. • There is no longer a limit on the number of shareholders in a private company. • A private company can benefit from government programmes if they comply with the relevant legislation. • Personal liability of share-holders does not affect the company's assets.	• Formation procedures are time consuming/complicated/ expensive, as many legal documents need to be prepared/submitted. • High formation/establishment expenses require large start-up capital. • Annual audit of financial statements (if required) is costly. • If a private company does not comply with legislation, its licence maybe withdrawn by the Companies and Intellectual Property Registration Office (CIPRO)/Companies and Intellectual Property Commission (CIPC).
Taxation	• Can obtain tax rebates if they are involved in SCI projects. • Can obtain government tenders and renew their licenses if they do not evade tax.	• Subject to double taxation e.g. shareholders pay secondary tax this can have a negative impact to a company that is already financially struggling.
Division of profits	• High profits and good returns to shareholders indicate the success of a company, which increases the value of shares. • Profits generated can be re-invested to expand business operations. • Shareholders receive profits according to the type and number of their shares.	• Shareholders may sell their shares when dividends are low, resulting in a drop in share prices. • Dividends are not always paid out which may discourage new investors.

SOLE PROPRIETOR		
Capacity	• Easy to control since it is a small business.	• Difficult to continue and grow long term. • Difficult to get good, well-trained staff as they are expensive. • Owner has to manage and carry out all business functions.
Legislation	• No registration required to establish this business. • Expensive annual audit of financial statements is not required. • Unlimited liability may encourage the owner to work harder to ensure the success of the business.	• Personal debts and business debts are one. • Must comply with relevant municipal regulations to avoid closing down. • The owner is personally liable for the business debt; he/she may be reluctant to take calculated risk.
Taxation	• Owner only taxed on profits in personal capacity. • Depending on how much income the owner earns, his/her tax rate may be lower than the company tax rate. • If the owner earns below a certain threshold amount per year, no income tax is payable and the business's profits are thus not taxed.	• If profits get too big may end up paying high tax in personal capacity. • Failure by the owner to comply with personal income tax regulations could lead to substantial financial penalties imposed by SARS.
Capital	• Capital can be carefully spent and managed. • The owner may be able to borrow money from a financial institution, especially if he/she has assets that can be used as surety for a loan.	• Limited capital available for expansion. • Cannot appoint people with large salaries. • Owner responsible for any capital borrowed.
Management	• One owner so there is no disagreements. • Can make quick decisions without having to consult others.	• Owner has to do all the administration, management and decision-making in the business. • Owners has to rely on own decisions and could make incorrect ones.
Division of profits	• Owner receives all profits from the business which can lead to capital growth.	• Owner needs to budget carefully so that business debts are covered. • If the owner does not make a profit, the income and livelihood of the owner may be severely affected.

You need to know the characteristics, advantages and disadvantages of all forms of ownership. This will enable you to evaluate the factors that contribute to the success and/ or failure of each form of ownership. These factors form part of the advantages (success) and/ or disadvantages (failure) of each form of ownership

ACTIVITY 2

2.1 Read the scenario below and answer the questions that follow:

> Grobler and Sons want to establish a private company. Their business proposal contains the following aspects:
>
> - Name of the company will end with LTD.
> - Complete the memorandum of association and articles of association.
> - Appoint one director.
> - Maximum of fifty shareholders.

2.1.1 Evaluate Glober and sons' business proposal in terms of the characteristics of the private company and make recommendations for improvements. (12)

2.1.2 Explain the differences between a private company and a state owned company. (8)

ANSWERS TO ACTIVITY 2

2.1.1 **Evaluation of a private company based on the above aspects.**

- The name of the company does not end with LTD.√
- The memorandum of association and article association do no longer exist.√
- The company is no longer managed by one director.√
- The shareholders are no longer limited to fifty people.√ Sub max (4)

Recommendations

- The name of the private company must end with (PTY) Ltd.√√
- The company must file the Memorandum of Incorporation (MOI) with the Companies and Intellectual Property Commission (CIPC).√√
- The company can appoint three or more directors √√

- The number of shareholders can be more than fifty.√√ Sub max (8)

Max (12)

2.1.2 **Differences between a private company and a state owned company**

Private company	**State owned company**
-The company name ends√ in (PTY) Ltd√	-The company name ends√ with SOC.√
-Shareholders share the profit√ of the company in the form of a dividend.√	-Profits are distributed √ to all sectors.√
-Does not offer√ essential services.√	-Offer essential services√ which may not be offered by the private sector.√
-Charge high prices√ for goods and services.√	-Prices are kept√ reasonable.√
Sub max (4)	Sub max (4)

Max (8)

ACTIVITY 3

3.1 Explain factors that contribute to the success/failure of state owned company in terms of the following criteria:

3.1.1 Capital (4)
3.1.2 Management (4)
3.1.3 Legislation (4)

ANSWERS TO ACTIVITY 3

FACTOR	**SUCCESS**	**FAILURE**
Capital	• A large amount of capital can be raised√ since there is no limit on the number of shareholders.√ • Large amount of capital enhances growth√ and advancement in technology for the SOC.√ • The company can access long term capital√ and therefore has good long term growth opportunities.√	• Shares are not freely transferable, so less capital can be raised/Prohibited √ by its Memorandum of Incorporation (MOI) from offering its shares to the public, which limits the amount of capital that can be raised for expansion.√
Max (4)		

Manageme nt	• Management is in the capable hands of a board of directors' √ that have skills, knowledge and abilities.√ • Shareholders can vote for/appoint √ the most capable directors to manage their company.√ • Directors are jointly and severally liable for all company's debts and liabilities incurred. √ This forces them to act responsibly and work harder towards the success of a company.√	• Directors may not have a direct interest in the company√, which can hamper growth and profit maximization.√ • SOC and its shareholders are compelled to budget a larger amount√ for directors remuneration to attract the best directors.√ • Directors' fees increase√ the company's expenses which reduces net profit.√
Max (4)		
Legislation	• The company and its shareholders are separate entities√, which may encourage more people to join the company.√ • Directors are forced (by the Act) to act responsibly√ and work harder towards the success of the company to protect their personal assets.√ • May obtain government tenders√ a is properly registered in compliance with the Companies Act.√	• Lengthy registration requirements may delay the actual operation of the business√ and shareholders can loose on profitable opportunities.√ • It is expensive to register this form of ownership √ which increases business expenses hence reducing profit.√ • The drafting of directors' performance contracts may be time consuming/expensive √ and increase costs.√
Max (4)		

ACTIVITY 4

4.1 Read the statement below and answer the questions that follow

Christopher wants to start a business that will enable the shareholders to have limited liability even though he will be subjected to unlimited liability as a director of the company.

4.1.1 Name the form of ownership that is applicable to the scenario above. Motivate your answer by quoting from the scenario. (3)

4.1.2 Justify the effectiveness of the form of ownership identified in QUESTION 4.1.1 (8)

4.1.3 Explain the differences between the form of ownership identified in QUESTION 4.1.1 with the public company. (8)

ANSWERS TO ACTIVITY 4

4.1.1 Personal liability company√√ **(2)**

Motivation

Christopher will be subjected to unlimited liability as a director of the company.√ **(1)**

4.1.2 **Effectiveness of the personal liability company**

Positives/Advantages

- More opportunities √ to pay less taxation.√
- Good long-term √growth opportunities.√
- Own legal identity √ and shareholders have no direct legal implications.√
- Employ or elect own management√ and the directors. √
- Not required to file annual financial statements √ with the commission.√

AND/OR

Negatives/Disadvantages

- Requires a lot of capital√ for establishment.√
- The more shareholders √, the less profits. √
- More taxation requirements√ as it has a limited liability.√
- Annual financial statements must be reviewed by a qualified person√, which is an extra expense to the company. √ **Max (8)**

4.1.3 **Differences between the Personal Liability Company and public company**.

Personal Liability Company	**Public company**.
• The name ends in INC√	• The name ends in Ltd. √
• Public cannot buy√ shares in company√	• Public can buy shares √in company√
• Raises capital√ by issues shares to its shareholders. √	• Raises capital √ by issuing shares to the public and borrowing capital by issuing a debenture√
• Financial statements must be independently reviewed√ but not necessarily audited.√	• Annual financial statements√ need to be audited.√
• Does not need to publish a prospectus√ as it cannot trade its shares publicly.√	• Have to register and publish√ a prospectus with CIPRO.√
• The company is not required to raise√ the minimum subscription/ issue minimum shares.√	• Must raise a minimum subscription prior√ to the commencement of the company.√
Sub max (4)	Sub max (4)

Max (8)