Chapter 2 Forms of Business Ownership

Summary

1. Sole Proprietorship and Partnership

1.1 Characteristics of Sole Proprietorship and Partnership

	Sole proprietorship	Partnership
Name of owner	Sole proprietor	Partner
Number of owner	1	At least 2
Legal entity	No. The owner is responsible for the **(1)** **legal charges** of the sole proprietorship.	
Continuity	No	
Owner's liability	A sole proprietor bears unlimited liability.	• Partners' liability is **(2)** **joint** and **(3)** **several** • **(4)** **Limited partners** enjoy limited liability • **(5)** **General partners** bear unlimited liability
Management	A sole proprietor has absolute control over the management of the sole proprietorship	• Every general partner has the right to manage the partnership. • Limited partners do not have the right to take part in the management

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1.2 Advantages and Disadvantages of Sole Proprietorship and Partnership

<table>
<tr><th></th><th>Sole proprietorship</th><th>Partnership</th></tr>
<tr><td rowspan="2">Advantages</td><td colspan="2">• Simple set-up procedure
• Lower (6)<u>profits tax</u> rate than that of limited company</td></tr>
<tr><td>• Close customer relationship
• High management (7)<u>flexibility</u>
• Easy transfer of ownership</td><td>• Wider sources of capital compared with sole proprietorship
• Practice of (8) <u>division of work</u> among partners
• Sharing of risk among partners</td></tr>
<tr><td rowspan="2">Disadvantages</td><td colspan="2">• The business has no independent (9) <u>legal status</u>. Owner bears unlimited liability and shoulders legal responsibility
• The business will be (10) <u>terminated</u> if the sole proprietor or any partners retires, goes bankrupt or dies</td></tr>
<tr><td>• Limited sources of capital
• Heavy workload bore by the sole proprietor
• Smaller in scale, which has a hard time competing with large corporations</td><td>• (11)<u>Collective responsibility</u> of faults
• Longer decision-making process when partners have conflicted opinions
• More difficult to transfer ownership</td></tr>
</table>

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2. Limited Company

2.1 Characteristics of Private and Public Limited Companies

	Private limited company	**Public limited company**
Owner	People who own the shares of the company (i.e. **(12)** **shareholders**)	
Number of owners	1-50	≥1
Restriction on company name	Must carry the word "Limited" (or "Ltd") in the company name	
Legal entity	Yes	
Owners' liability	Shareholders enjoy **(13)** **limited liability**. Their losses will be limited to the amount they have invested if the company goes bankrupt.	
Management	• Ownership and management are separated • Shareholders own the company and they elect a **(14)** **board of directors** to run the company	
Sources of capital	The company can raise capital from existing shareholders.	The company can raise capital by issuing shares to the public.
Transfer of ownership	Requires the approval of the board of directors	• Shares are freely transferrable • Only the shares of listed companies can be traded on the stock exchange

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Disclosure of financial information	Not required to disclose its financial information to the public	• Public limited companies are required to disclose its financial reports and accounts to the public • Listed companies are obligated to follow the Listing Rules in disclosing financial information

2.2 Advantages and Disadvantages of Private and Public Limited Company

<table>
<tr><th></th><th>Private limited company</th><th>Public limited company</th></tr>
<tr><td>Advantages</td><td colspan="2">• A limited company is a separate legal entity, which enjoys the following advantages:
■ It has continuity in operations.
■ Shareholders enjoy limited liability and can reduce (15)<u>investment risks</u>.
■ Shareholders do not need to take legal responsibility for the company.
• A limited company can raise capital from shareholders by issuing shares. Its source of capital is wider than that of sole proprietorship or partnership.
• A limited company are normally large in scale, which enjoys the following advantages:
■ (16)<u>Economies of scale</u> is achieved by mass production and purchasing raw materials in bulk, hence reducing average production costs.</td></tr>
</table>

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<table>
<tr><td rowspan="2"></td><td colspan="2">

■ It is able to employ professionals to run the company and increase efficiency.
■ It is easier to build up **(17)**<u>**goodwill**</u> and enjoy better terms when borrowing bank loans.

</td></tr>
<tr><td>

• It is not required to disclose financial information.

</td><td>

• The source of capital is wider than that of a private limited company as a public limited company can raise funds from the public.
• The shares of a listed company are freely transferrable on the stock exchange.
• The listing of company can attract more attention from the public, which is easier to build up goodwill.

</td></tr>
<tr><td>**Disadvantages**</td><td colspan="2">

• The profits tax rate is higher than that of sole proprietorship and partnership.
• The set-up cost is higher and the procedure is more complicated.
• The company is less flexible in decision-making as the **(18)** <u>**organisational structure**</u> is more complex.
• Problems associated with the separation of ownership and management include:
■ Lower **(19)**<u>**incentives**</u> for managers to improve the company's operation.

</td></tr>
</table>

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	■ The pursuit of short-term goals by managers, which may hinder the company's long-term development.	
	• Hard to transfer ownership as the transfer of shares needs the approval of the board of directors • Limited sources of capital as it is subject to upper limit for shareholders	• The company has to incur extra costs such as listing and legal fees for going public. • It is required to publish its accounts to the **(20)** **public**. • The control of existing shareholders over the company may be threatened.

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3. Joint Venture and Franchising

3.1 Characteristics of Joint Venture and Franchising

	Joint venture	Franchising
Nature	• A **(21)<u>contractual</u>** arrangement • Two or more partners work on a project together • Some joint ventures exist in a specific **(22)<u>time frame</u>**. They will be terminated upon the completion of the project	• A **(23)<u>business network</u>** that allows a number of people to share a brand or an operational method in running a business
Operation	• Each partner contributes its own capital, assets or technology to the joint venture • There is no requirement on the form of business ownership, but it is usually formed as a limited company	• A franchisor grants the right of using the **(24)<u>trade mark</u>** or **(25)<u>method</u>** to franchisees • **(26)<u>Franchisees</u>** are required to pay a franchise fee to the franchisor. They must run the business in the way required by the franchisor • The **(27)<u>franchisor</u>** is obligated to provide training and technical support for the franchisees
Management	• The joint venture is jointly controlled by the partners	• The franchisor and franchisee are two separate parties

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3.2 Advantages and Disadvantages of Joint Venture

Advantages	Disadvantages
• **(28)**<u>**Synergetic effect**</u> occurs when the strengths of the parties are combined. • When an overseas business forms a joint venture with a **(29)** <u>**local**</u> company, the joint venture will be subject to less severe regulations. • Risks are shared by the partners as each partner has to contribute capital, assets or other resources to the joint venture. • Resources are pooled by the partners for the development of new products and services.	• Risks of valuable knowledge and technology being seized by partners • Less flexible in decision-making as partners need to reach a **(30)**<u>**consensus**</u> • Conflicts may arise due to the following reasons: ■ Difference in **(31)**<u>**corporate culture**</u> ■ Divergent views on business development ■ Arguments over the share of profit

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3.3 Advantages and Disadvantages of Franchising

	Franchisor	Franchisee
Advantages	• **(32)**<u>**Expand**</u> and **(33)**<u>**dominate**</u> market in a short period of time • The cost of expansion is shared by the franchisees, which can reduce **(34)**<u>**financial risks**</u>	• Easy to enter the market • Receive support from the franchisor, such as staff training, operation system • The **(35)**<u>**cost of purchases**</u> can be reduced as the franchisor purchases materials in bulk • It is easier to make a profit using the well-known trade mark and successful operation system
Disadvantages	• It is difficult to control the quality of products and services when the number of franchisees is large. • The image of the franchisor will be adversely affected by the franchisees who do not follow the rules	• As franchisees have to strictly follow the rules set by the franchisor, the following problems arise: ■ Franchisees cannot adjust the price and product according to the **(36)**<u>**market demand**</u> ■ Franchisees cannot adjust the types of products and services provided

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		• Franchisees cannot solely own the profit as they are required to pay management and promotional fees

4. Public Enterprise

4.1 Advantages and Disadvantages of Public Enterprises

	Government department	Public Corporation
Owner	Government	
Operation	Directly financed and managed by the government	• **(37)Profit-oriented** and run on commercial principles • The government appoints a board of directors to manage daily operations
Advantages	• Provide essential goods and public services to people in reasonable and **(38)affordable** price • As they are financed by the government, they enjoy the following advantages: ■ Abundant resources for large-scale projects ■ Better terms of loans and purchase lower the running costs ■ The government provides up-to-date information so as to make better decision	

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Disadvantage	• Low incentive to make improvement as they are not run on **(39)** **commercial principles** • Their organizational structure is **(40)complicated**, resulting in low degree of flexibility in decision-making • The government bears the losses of public enterprises. If public enterprises are poorly performed, **(41) taxpayers** will have to bear the losses

4.2 Recent Development of Public Enterprises

Trend	• Run on a **(42) Self-financing** basis • Introduce **(43) commercial principles** in operations to improve the quality of services
Forms	**Trading fund:** Government departments have to operate on a self-financing basis and are given the autonomy on resource management **Outsourcing:** Some government services and projects are outsourced to private organisations **Privatisation:** Some of the shares of several public enterprises are sold to the public.
Objectives	• Enhance **(44) operational efficiency** • Reduce government's **(45) financial burden**

5. Multinational Corporations (MNC)

Definition of multinational corporations	• It manages production establishments or delivers services in at least two countries • Most of them are listed companies with huge sum of capital
Characteristics	• **Operating in many countries:** Establish offices and factories in different countries • **Complicated organizational structure:** Large scale of business and large number of employees • **Economies of scale:** Large scale of production which can fully utilize **(46)production capacity** • **Strong bargaining power:** Owing to the large scale of production, MNCs can purchase raw materials in bulk and ask for better **(47)terms of purchase** more easily • **Advanced technology:** Make use of advanced technology to increase production efficiency and have sufficient funds to develop new technology
Contributions	• Inflow of capital • Provision of job opportunity • Development of new technology and skills • Stimulation of business activities

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