South Tuen Mun Government Secondary School

S3 Business, Accounting and Financial Studies (BAFS)

#7 Types of Limited Companies

Limited Company

A limited company is a business with a **separate** legal existence and is usually owned by **many** people.

The ownership of a limited company can be divided into **shares** (also called stock), so a limited company is also called **joint**-stock company.

Investors are called **shareholders** (also called stockholders) and their liability is limited to the amounts of money they have **invested**.

Shareholders do not necessarily **run** the business. They may appoint **directors** for this purpose.

Types of limited companies

Every limited company **incorporated** in Hong Kong is either private limited company or a public limited company.

Private limited company

A private limited company is called private because its shares cannot be sold to the **public**. It must have between 1 and 50 shareholders. A private limited company does not need to disclose its **financial** information to the public.

If shareholders wish to sell their shares, they may be required to first **offer** them to the existing shareholders of the company. Otherwise, the board of directors has the power to refuse to **register** transfer of shares.

Many private limited companies in Hong Kong are **family** businesses. They are set up to obtain **capital** without losing **control** of the business.

Public limited company

A public limited company can sell its shares to the **public**. The number of shareholders in a public limited company has no **upper** limit, but there must be at least **one** shareholder.

Since shares of a public limited company are sold to the general public to raise **capital**, there are usually many shareholders. A public limited company needs to **disclose** its financial information to the general public every **year**.

In Hong Kong, a public limited company can become a **listed** company by applying to Hong Kong Exchanges and Clearing Limited (HKEx) for **listing**. Before shares are offered for sale, the company decides how much capital it needs and therefore how many shares are to be sold. After becoming a listed company, the general public can buy and sell shares of the company on the **stock** market.

Differences between private and public limited companies

	Private limited company	Public limited company
Number of shareholders	1-**50**	At least one, no upper limit

Raising Capital	● Invite new shareholders to join ● Raise capital from existing shareholders	More sources of capital: ● Raise capital from existing shareholders ● **Issue** new shares to the public

Disclosure of financial information to the general public	**Not** Required	Required

Transfer of shares	The board of directors has the power to refuse to register share transfers Shares cannot be sold on the stock **market**	Shares can be **freely** transferred. Shares can be bought and sold freely on the stock market if they are listed on a stock market.

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#8 Characteristics and shares of a limited company

Characteristics of a limited company

1. Separate legal existence

By law, a limited company is an entity with a separate legal existence and is therefore **independent** of its owners. The company's future is not **threatened** by the illness or death of its owners.

2. More sources of capital

A listed company can raise capital by issuing shares to the general **public**. So it is easier for a public limited company to raise capital. Banks are more likely to give **loans** to limited companies as their scale of **operation** is usually large enough for them to have the **ability** to repay the loans.

3. Restriction on the company's name

A limited company must have the word '**Limited'** or 'Ltd' as the last word in its name.

4. Limited liability

Shareholders have limited liability. Their liability is limited to the amount they have **invested**.

5. Separation of ownership and management

A limited company may have a large number of **shareholders**. Shareholders may not have the **ability** or time to manage the company and so may elect a board of **directors** to run the business. This is a **usual** practice for public limited companies since their shares may be **transferred** frequently.

6. Large scale of business

A limited company may have a huge number of shareholders and **employees**. Also, since they have more sources of capital, limited companies are usually **large** in scale.

Types of shares of a limited company

There are two main types of shares:

1. Ordinary shares

Ordinary shares are the main **source** of a company's capital. A company may pay **dividends** to its shareholders. In general, ordinary shareholders **earn** more dividends when the company earns more **profits**. Sometimes dividends are not **distributed** even though the company is earning profits because the company wants to use the profits for further **investment**.

Ordinary shareholders have **voting** rights at the annual general **meeting** and can elect a board of directors to **run** the company.

2. Preference shares

Preference shareholders receive dividends **before** ordinary shareholders are paid and have **fixed** dividends. However, preference shareholders have **no** voting rights.

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#9 Advantages and disadvantages of a limited company

When compare with sole proprietorships and partnerships, limited companies have the following advantages and disadvantages:

Advantages	Disadvantages
1. Shareholders have limited liability, and can thus avoid the **loss** of their personal **assets**.	1. Setting up a limited company is **complicated** because more documents are required for **registration**.

2. It is a **separate** legal entity. **Changes** in shareholders and directors will not affect the running of the company, so it has **continuity**.	2. The profits tax it pays (**16.5**%) is higher than a sole proprietorship or partnership (15%) (from the year of 2008-09 onwards)

3. It is **easier** for a limited company to raise **capital** than a sole proprietorship or partnership, resulting in a better chance of **development.**	3. The structure of the company may be so large and **complex** that the process of **decision**-making takes time. This results in a lack of **efficiency**.

4. The **size** of the business is larger than a sole proprietorship or partnership and so it is able to operate on a **large** scale.	

Comparison between private and public limited company

	Private limited company	Public limited company
Advantages	1. No need to **disclose** a lot of information 2. Shares are not bought and sold **freely**, so the **existing** shareholders have better **control** of the company. 3. Lower **accounting** costs in preparing financial statements are incurred. 4. The legal and administrative **procedures** for forming a private limited company are less **complex** and **costly**.	1. It is easier to obtain **loans** from banks and make purchases on **credit** because of its higher **creditworthiness**. 2. If the company becomes a listed company, more **capital** can be raised by issuing **shares** on the stock market. 3. The separation of ownership and **management** enables the company to hire **specialists** to assume different roles. This improves the company's management and **efficiency**.

Disadvantages:	1. It is more **difficult** to raise capital as the creditworthiness of a private limited company is **lower** than that of a public limited company. 2. Shares cannot be easily **transferred** as the board of directors has the power to **refuse** to register share transfer.	1. The company needs to disclose much more information, including its **financial** information. 2. If **most** of the shares fall into the hands of other, the existing shareholders may lose control of the company. 3. If it is a listed company, the **price** of its shares will be affected by the many other factors on the **stock** market.

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#10 Characteristics of a Franchise

Many well-known business in the **retailing** businesses operate under a franchise arrangement. The owner of the ***franchise*** (**franchisor**) **allows** the owner of a ***retail business*** (**franchisee**) to sell its goods or services, in return for a franchise **fee**. Franchising is a way for franchisees to operate as **chain** stores.

Franchisees are often required to pay **royalties** to the franchisor, and share management and **promotional** fees with the franchisor regularly. Some franchisors calculate royalties based on the gross sales or gross **profits** that the franchisees earn. Franchisees must operate their businesses in a **similar** way to that of the franchisor. The franchisor will provide management **training** to franchisees before they **start** their businesses.

For the franchisor, franchising provides the business with an opportunity to **grow** with capital and **manpower** provided by the franchisees. Examples of franchised businesses are 7-eleven, Grove Sandwiches, FitBoxx.com, Kodak Express and Quality Dry-Clean.

Characteristics of a franchise

1. Brand name well regarded by customers

Most franchises have built up a good **reputation** for their **products** or services. They are **recognized** by customers as having good, consistent quality.

2. Support from the franchisor

Franchisees receive the franchisor's **support** in operating the business. For example, the franchisor helps the franchisees set up the **accounting** system and provides credit for **inventory** purchase. The franchisor also provides training to franchisees and their **employees**.

3. Standardized operation

The store's **look**, staff **uniforms**, logos, products and prices are **standardized** according to the franchisor's requirements.

4. Control by the franchisor

The franchisees are required to operate their businesses according to the franchisor's **instructions**. The operations of the stores, such as the product **display** and selling **strategy**, are monitored regularly by the franchisor.

5. Sharing of promotional expenses

The franchisees share the **cost** of promotional campaigns which are carried out by the franchisor.

6. Chain stores in different locations

The franchise system operates as a chain with stores located in **different** areas. For example, 7-Eleven has stores in many Hong Kong districts.

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#11 Advantages and disadvantages of operating Franchised shops-(i)

To franchisees

Advantages	Disadvantages
1. Franchisees obtain **support** from the franchisor in terms of marketing, **inventory** supplies, accounting and management.	1. Franchisees are often required to pay **royalties**, **promotional** and **management** fees to the franchisor whether or not a **profit** is earned.

2. Franchised stores have built up **goodwill**. Their products are **well-known** and accepted by customers.	2. Franchisees may rely too heavily on the support of the **franchisor**.

3. It is **easy** to set up the business as the franchisor provides a wide range of support to franchisees.	3. Some franchisors' head offices are located overseas, so franchisees may find it difficult to **communicate** and receive support within a short time.

4. Franchisees enjoy the benefits of a **large** shop, such as lower **costs**, when buying stock in **bulk**.	4. Franchisees may have less **independence** in operating their businesses as the franchisor operations.

5. The **management** system of franchised stores helps establish goodwill quickly.	

Dictation

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#12 Advantages and disadvantages of operating Franchised shops-(ii)

To franchisors

Advantages	Disadvantages
1. Franchisors can obtain capital from franchisees who have to pay a franchise **fee** to join the franchise.	1. Franchisors need to make a **huge** investment to build the franchise system and **infrastructure**, and to provide **training** and support to franchisees.

2. **Operating** costs of franchisors can be reduced as their promotional and management fees are **shared** by franchisees.	2. Franchisors may not have complete **control** over their business. Franchisees may ruin the **reputation** of the business if they manage their outlets **poorly**.

3. Franchising provides the business with an opportunity to **grow** and build the brand with **capital** and **manpower** provided by franchisees.	3. Franchisors may need to disclose **confidential** information to franchisees who may become their future **competitors**.

4. The **risk** of the business is shared by franchisees who have also **invested** money in the business.	

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