Chapter 2 Forms of Business Ownership

Business Aids 1

Privatisation Proposal of Property Developer

In November 2013, a Mainland property developer, which is listed in Hong Kong, released an announcement expressing that its major shareholder offered $1.8 per share to privatise the company.

According to the announcement of the company, the major shareholder considered that the depressed price of the company's shares had had an adverse impact on the company's reputation, thus affecting its business and staff morale. In addition, the announcement pointed out that the low circulation of the shares for a significant period of time was not beneficial to investors. The cancellation price $1.8 per share was 45% higher than the closing price on the last trading day before the announcement of the proposal. However, it was still much lower than its issue price.

Investment analysts held divergent views towards the privatisation proposal. Some expressed that the proposal was not attractive to minority shareholders. Some were concerned that the company would lose an important source of financing after privatisation. This may have an adverse impact on the company's financial conditions in the future.

Questions:

1. According to the above information and your knowledge, how can the company and investors benefit from the privatisation proposal?

   Company: The depressed price of the company's shares had damaged the public's confidence in the company, thus affecting the company's reputation. The implementation of the proposal would eliminate such impacts. In addition, the company can keep its financial information secret and enjoy greater autonomy on decision-making after privatisation.

   Investors: To those who held the company's shares, the proposal would reduce their losses. In addition, the circulation of the shares in the stock exchange has been low for a significant period of time. This made it difficult for investors to sell the shares and they might incur a loss. The proposal provided an opportunity for investors to realise their investments in cash.

2. How would the sources of financing of the company be affected after privatisation?

   A listed company can raise funds from the public by issuing shares on the stock exchange. It is relatively easy for listed companies to raise funds. After privatisation, the sources of financing of the company would be limited. It may have difficulty in raising funds in the future.

3. If you were the shareholder of the above-mentioned company, what would you consider when evaluating the privatisation proposal? Discuss with your classmates.

   Any reasonable answers.

Business Aids 2

Hung Fook Tong Changed Its Operation Model

Hung Fook Tong, a local herbal tea brand, operated as a franchising business more than ten years ago. It had up to 70 branches, of which 80% were run by franchisees and 20% by Hung Fook Tong itself.

After the Asian financial crisis in 1997, some of the franchisees found it hard to maintain the business and earn profits. They sold products other than herbal tea in their branches to increase turnover. However, this caused considerable damage to the brand image of Hung Fook Tong. The sales performance of Hung Fook Tong was also severely affected.

Hung Fook Tong later restructured its operations and took back all the franchises. The company changed its management strategies and opened branches in housing estates and along MTR stations in order to provide quality products and comfortable environment for customers.

Questions:

1. According to the above information, in what way did Hung Fook Tong operate over ten years ago? Why did the company decide to change this operation model?

   Hung Fook Tong ran as a franchising business more than ten years ago. It later found that some franchisees sold products other than herbal tea without approval, which caused an adverse impact on the brand. Thus, Hung Fook Tong changed its operation model.

2. With respect to the case of Hung Fook Tong, what problems do franchisors face?

   As there are many franchisees, franchisors may not be able to supervise all of them. If franchisees provide services or sell goods that are not up to standard, the brand name will be severely affected.

3. What measures can be taken by a franchisor to supervise franchisees?

Franchisors can sign an agreement with franchisees to make sure that the franchisees run their businesses as required. Franchisors can evaluate franchisees regularly and terminate the contract with franchisees who violate the agreement. Franchisors can provide additional assistance to franchisees who have good business performance and punish those who violate the agreement.

Answers to Short Questions

18. A sole proprietorship is owned by one person (i.e. sole proprietor) only. He/she can make decisions himself/herself in a short period of time. (1)

A sole proprietorship is usually small in scale. The sole proprietor usually has direct contact with customers. (1)

A sole proprietorship is not a separate legal entity and thus it does not have continuity. If the sole proprietor retires, goes bankrupt or dies, the business will be terminated. (1)

The procedure for setting up a sole proprietorship is easy and the set-up cost is also low. (1)
(Any three)

(Total: 3 marks)

19. A sole proprietorship has higher flexibility in management than a partnership since the sole proprietor can make decision on his/her own while partners in a partnership have to reach a consensus for business decisions. (1)

A sole proprietor can easily transfer the business to others. If a partner wants to transfer the ownership to others, he/she must obtain approval from other partners. (1)

Partners have collective responsibility for the partnership. If one partner makes a wrong decision, the other partners will be responsible for the consequences. (1)
(Any two)

(Total: 2 marks)

20. A listed company can enjoy wider source of capital. (1)
They can issue new shares and raise funds from the public. In addition, there is no upper limit for the number of shareholders in a listed company. (1)

A limited company can establish goodwill and enhance brand awareness in the minds of the public by being listed on the stock exchange. (1)
It can then maintain its competitive edge and gain more market share. (1)

It can have more resources to improve its performance. (1)
Since it enjoys a wider source of capital, it has more resources for further development, such as expansion. It can also employ professionals to manage the company, which can improve the company's operational efficiency. (1)
(Any two)

(Total: 4 marks)

21. A joint venture is usually a limited company and has its own legal status. (1)
It is independent of the parties who formed the joint venture. Its assets and liabilities belong to the joint venture itself. (1)

A joint venture is jointly controlled by the parties that set up the joint venture. (1)
They usually take part in the management of the joint venture and contribute capital, assets or technology to the joint venture. They must reach a consensus when important decisions are made. (1)

(Total: 4 marks)

22. A multinational corporation (MNC) enjoys a wider source of capital. (1)

MNCs usually enjoy economies of scale by their large scales of production. (1)

MNCs may employ professionals to manage the business and increase operational efficiency. (1)

MNCs usually automate production processes and make use of advanced technology to reduce production cost. (1)
(Any three)

(Total: 3 marks)

23. Many multinational corporations are listed companies. They can raise funds from the public by issuing shares and bonds. (1)

Multinational corporations can obtain funds by borrowing bank loans. (1)

If multinational corporations have retained profits, they can use the funds for operations and expansion. (1)

(Total: 3 marks)

24. (a) The Transport Department is a government department and thus a public enterprise. (1)

(Total: 1 mark)

(b) Public enterprises aim to provide public services to the public. The public can enjoy quality and essential goods and services at an affordable price. (1)

Public enterprises can gain financial support and receive latest information from the government, which helps set up future plans. (1)

Public enterprises are large in scale. It is easier for them to obtain favourable terms and conditions of loans and purchase, which can lower operational costs and save taxpayers' expenses. (1)
(Any two)

(Total: 2 marks)

25. A limited company is usually large in scale and has a more complicated organisational structure. (1)
More people are involved in decision-making process. It takes a long time to reach a consensus among them about a decision. (1)
Since more people are involved in decision-making, conflicts may easily break out. (1)

(Total: 3 marks)

26. (a) Alice and her friends need not take legal responsibility for the business. (1)
A limited company has its own legal entity. Shareholders are not liable for legal charges against the company. On the contrary, partners have to take the legal responsibility for the partnership. (1)

Alice and her friends can enjoy limited liability for the business. (1)
They will only lose the capital invested in the company in case of business failure. On the other hand, partners may need to use personal assets to repay the debts for the partnership in case of dissolution. (1)

It can ensure the continuity of the business. (1)
A limited company can continue its operations despite the changes in ownership such as withdrawal and admission of shareholders. For partnership, it will be terminated if any general partner goes bankrupt, dies or withdraws. (1)
(Any two)

(Total: 4 marks)

(b) Partners are responsible for the management of the partnership (except limited partners). They have to make the major business decisions and take care of the partnership's operations. (1)

In a limited company, the management and ownership are usually separated. Shareholders generally do not take part in daily operations of the company. They elect a board of directors to manage the company. (1)

(Total: 2 marks)

27. (a) Frontier could reduce its business risks in developing new products. (1)
By forming a joint venture, the risks could be shared among Frontier and Mango. Frontier did not need to bear all the risks involved in developing new tablet computers. (1)

A joint venture has a wider source of resources to develop new products. (1)
After the joint venture "Zeus" was formed, both companies would provide resources, such as funds, staff and technology to develop new tablet computers. (1)

It was easier for Frontier to enter the market of tablet computers. (1)
Frontier was a mobile phone manufacturer. It might not be familiar with the market of tablet computers. By forming a joint venture with the consumer electronics brand Mango, Frontier could acquire more information of the market. (1)
(Any two)

(Total: 4 marks)

(b) The two companies were not sharing all their resources due to lack of trust. (1)
Mango refused to share its technology because it tried to avoid its own technology being seized by Frontier. Therefore, "Zeus" cannot fully utilise the resources of the two companies. (1)

Dispute might break out and hinder the cooperation among the two companies. (1)
The management of Frontier disagreed with Mango's approach which focused on marketing strategy. Since the two companies had different views on the development of "Zeus", they might not be able to concentrate their resources in one aspect and resulted in inefficient use of resources. (1)

(Total: 4 marks)

28. (a) Usually, the franchisor has established a reputation for the brand and built up customer loyalty. (1)
It is easier for Albert to attract customers and make a profit in a short period of time. (1)

The franchisor will provide advice and support necessary for the operations of the shop to Albert. (1)
Albert can make use of franchisor's resources and experience in operations to reduce the chance of failure. (1)

The franchisor will set the service standard for franchisees. (1)
It will help Albert set up an effective management system within a short period of time. (1)
(Any two)

(Total: 4 marks)

(b) Albert has to follow the rules of doing business as imposed by the franchisor, such as products and decoration of the shop. (1)

Albert has to pay a certain percentage of turnover, as specified in the franchise agreement, to the franchisor as management and promotion fees on a regular basis. (1)

(Total: 2 marks)

29. (a) Mr. Poon's fast food shop is a sole proprietorship. (1)

<u>**Disadvantages of a sole proprietorship**</u>

The owner has to bear unlimited liability for the business and repay the debts for the business when necessary. (1)

The owner has to bear legal responsibility for the business since sole proprietorship is not a separate legal entity. (1)

The business lacks continuity and will be terminated if the owner dies, retires or goes bankrupt. (1)

The owner has heavy workload as he has to make all the business decisions and take part in daily operations. (1)

The business's source of capital is narrow. It is obvious that such kind of business has limited resources and has a hard time competing with large corporations. (1)
(Any three)

(Total: 4 marks)

(b) Mr. Poon should develop a close relationship with customers by understanding their tastes and preferences. (1)
He can then customise menu to suit customers' tastes of food and increase their satisfaction. (1)

Mr. Poon should maintain a close relationship with employees. (1)
It helps boost staff morale and motivate the employees to provide better services. By improving the quality of services, customers are more willing to stay with the business. (1)
(Or other reasonable answers)

(Total: 4 marks)

(c) Mr. Poon is liable for the compensation personally. (1)
Since sole proprietorship is not a separate legal entity, the sole proprietor is responsible for any legal charges against the business. If the customer files a lawsuit, Mr. Poon is the one who is obligated to the legal consequences. (1)

(Total: 2 marks)

30. (a) Miss Lee and her friends can set up a private limited company. (1)
They can enjoy limited liabilities so as to minimise the loss in case of business failure. (1)

(Total: 2 marks)

(b) Shareholders of a limited company enjoy limited liability. (1)
When the company fails, the losses of Miss Lee and her friends are limited to what they have invested in the company. They are not required to repay the debts of the company with personal assets. (1)

A limited company is a separate legal entity. (1)
If the company is sued, Miss Lee and her friends are not responsible for the legal charges. (1)

As a limited company is a separate legal entity, it has continuity. (1)
Even when any one of the shareholders withdraws, goes bankrupt or dies, the continuity of the company will not be affected. (1)

A limited company has wider source of capital. (1)
More shareholders can join and contribute capital to the business. (1)
(Any three)

(Total: 6 marks)