

BAPS / Exam practice / ch 3-4 W. myt

# 3

## Forms of Business Ownership

Name : \_\_\_\_\_

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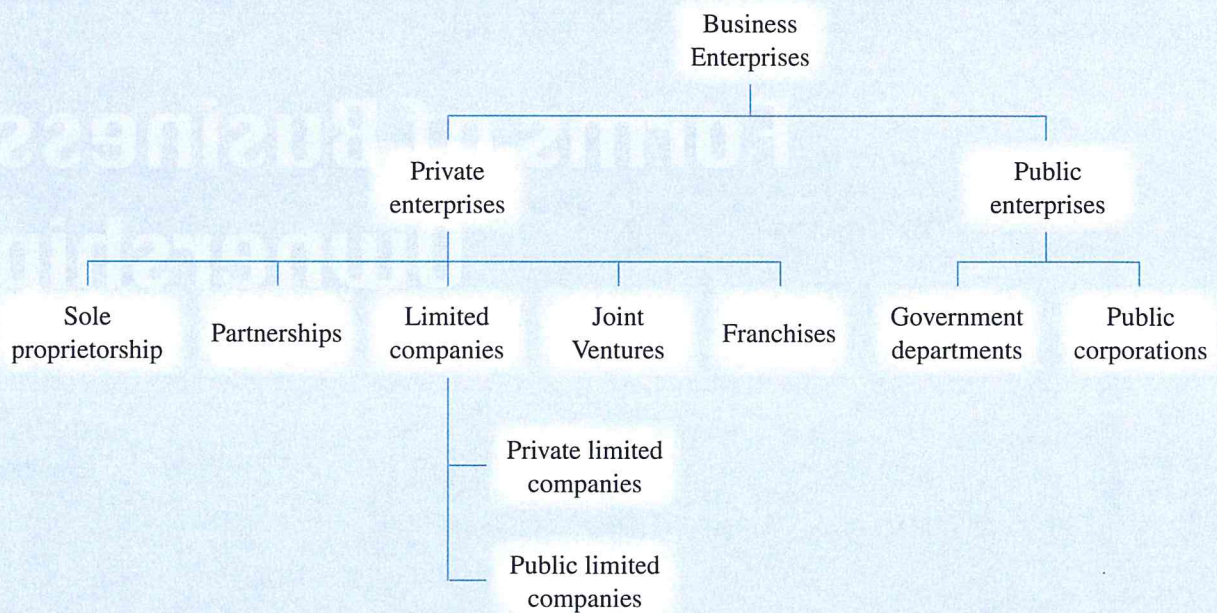




## Revision notes

### Forms of business ownership

- An enterprise produces and/or provides goods and/or services.
- Two major types of business ownership are
  - (i) private enterprises owned by private individuals and
  - (ii) public enterprises owned by the government.
- Different forms of business enterprises are outlined as follows:



### Sole proprietorship

A sole proprietorship is a business owned by one person.

#### **Characteristics of a sole proprietorship**

- Owned by one person: It is solely owned by one person.
- Unlimited liability: The liability of a sole proprietor is unlimited. If the business fails, the owner is responsible for paying off all the debts.
- Small scale of business: Since it is difficult for a sole proprietor to raise capital, the scale of business of a sole proprietorship is usually small.
- Managed by the owner: It is often managed by the owner. He makes all the business decisions and works long hours.



**Advantages and disadvantages of a sole proprietorship**

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>• It is easy to set up a sole proprietorship.</li> <li>• Little money is needed to set up the business.</li> <li>• Operation is more efficient and flexible as the owner can make decisions quickly according to changes in market demand.</li> <li>• The scale of a sole proprietorship is usually small. The owner is able to give customers personal attention.</li> <li>• As there are usually few employees, a sole proprietor can have a close relationship with his staff.</li> <li>• A sole proprietorship can enjoy a lower profits tax rate, compared with limited companies.</li> <li>• A sole proprietor can easily transfer ownership of the business to others.</li> </ul>	<ul style="list-style-type: none"> <li>• A sole proprietorship is not a legal entity. If the business fails, the sole proprietor may lose not only the business, but also all of his possessions.</li> <li>• A sole proprietor has a great responsibility and a heavy workload.</li> <li>• A single owner will probably not have all the skills necessary to properly develop the business.</li> <li>• The existence of the business always depends on the owner's good health.</li> <li>• A sole proprietor often has difficulty obtaining capital.</li> <li>• It may be difficult for a small business to compete with large businesses.</li> <li>• Heavy burden of some unavoidable costs</li> </ul>

**Partnership**

A partnership is an enterprise owned by at least two partners.

**Types of partners**

- According to their liabilities, partners can be classified into:
  - (i) limited partner: A limited partner's liability is limited to his investment in the business. He does not take part in running it.
  - (ii) general partner. A general partner has unlimited liability. He is involved in the planning and management of the business.
- According to the level of involvement, partners can be classified as follows:

Types of partners	Invest money	Ownership	Disclose identity	Take part in running the business
Active partner	✓	✓	✓	✓
Silent partner	✓	✓	✓	✗
Sleeping partner	✓	✓	✗	✗
Secret partner	✓	✓	✗	✓
Nominal partner	✗	✗	✓	✗



### Types of partnerships

There are two types of partnership:

- (i) General partnership: All the partners are general partners and have unlimited liability.
- (ii) Limited partnership: Includes one or more limited partners. But there must be at least one general partner with unlimited liability.

### Characteristics of a partnership

- Number of partners: There must be at least two partners.
- Unlimited liability: In the case of a limited partnership, there must be at least one general partner with unlimited liability.
- Small scale of business: With limited sources of capital, the scale of a partnership is usually small.
- Bound by the decisions made by others: All partners are legally bound by the decisions made by any one of the general partners in the name of the firm.

### Advantages and disadvantages of a partnership

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>• It is easy to set up a partnership.</li> <li>• Each partner can contribute specialised knowledge and ability to the business.</li> <li>• More capital will be available than in a sole proprietorship.</li> <li>• It is easier to attract employees as they may have a better chance of promotion.</li> <li>• A partnership can enjoy a lower profits tax rate, compared with limited companies.</li> <li>• The business risk will not be borne by only one person.</li> </ul>	<ul style="list-style-type: none"> <li>• General partners have unlimited liability.</li> <li>• A partnership is not a legal entity. The business may close if a general partner withdraws, dies or goes bankrupt.</li> <li>• As all decisions made should be agreeable to all partners, flexibility and efficiency may be lower.</li> <li>• All partners are bound by the decisions made by any one of the general partners.</li> </ul>

### Limited company

- A limited company has a separate legal existence and is owned by many shareholders. It is also called joint-stock company and investors are called shareholders.
- Investors are called shareholders and their liability is limited to the amounts of money they have invested.
- There are two types of limited companies: (1) private limited company and (2) public limited company.



	Private limited company	Public limited company
<b>Number of shareholders</b>	1-50	At least one, no upper limit
<b>Raising capital</b>	Invite new shareholders to join or raise capital from existing shareholders.	Raise capital from existing shareholders or issue new shares to the public.
<b>Need to disclose financial information to the public</b>	No	Yes
<b>Transfer of shares</b>	<ul style="list-style-type: none"> <li>The board of directors may have the power to refuse to register share transfers.</li> <li>Shares cannot be sold on the stock market.</li> </ul>	<ul style="list-style-type: none"> <li>Shares can be freely transferred.</li> <li>Shares can be bought and sold freely on the stock market.</li> </ul>
<b>Advantages</b>	<ul style="list-style-type: none"> <li>No need to disclose a lot of information.</li> <li>Shares are not bought and sold freely, so the existing shareholders can have better control of the company.</li> <li>Less accounting costs on preparing financial statements are incurred.</li> <li>The set-up procedures are less complex and costly.</li> </ul>	<ul style="list-style-type: none"> <li>It is easier to obtain loans from banks.</li> <li>More capital can be raised if it is a listed company.</li> <li>The separation of ownership and management enables the company to get specialists to take up different roles.</li> </ul>
<b>Disadvantages</b>	<ul style="list-style-type: none"> <li>More difficult to raise capital.</li> <li>Shares cannot be easily transferred.</li> </ul>	<ul style="list-style-type: none"> <li>Need to disclose much more information.</li> <li>If most of the shares fall into the hands of other parties, existing shareholders may lose control over the company.</li> <li>Share prices of a listed company will be affected by many factors.</li> </ul>



**Characteristics of a limited company**

- Separate legal existence: It 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.
- More sources of capital: Banks are more likely to give loans to limited companies. A listed company can issue shares to the public to raise capital.
- Limited liability: Shareholders' liability is limited to the amounts they have invested.
- Restriction on the company's name: A limited company must have the word 'Limited', 'Ltd' or the Chinese characters '有限公司' as the last word in its name.
- Separation of ownership and management: Shareholders may elect a board of directors to run the business.
- Large scale of business: With more sources of capital, limited companies are usually large in scale.

**Types of shareholders**

	Ordinary shareholders	Preference shareholders
Voting rights	✓	✗
Preference in receiving dividends	After preference shareholders are paid	Before ordinary shareholders are paid
Dividend amount	Variable	Fixed

**Advantages and disadvantages of a limited company**

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>• Shareholders have limited liability.</li> <li>• It is a separate legal entity. Changes in shareholders and directors will not affect the running of the company.</li> <li>• Raising capital is easier than it is for a sole proprietorship or partnership.</li> <li>• The size of the business is large, so it is able to operate on a large scale.</li> </ul>	<ul style="list-style-type: none"> <li>• Setting up a limited company is complicated.</li> <li>• It needs to pay a higher rate of profits tax.</li> <li>• The structure may be so large and complex that the process of decision-making takes much time.</li> </ul>

**Joint venture**

A joint venture is formed by two or more entities to develop, produce or sell products.

**Characteristics of a joint venture**

- Formation: A joint venture is formed by two or more entities (usually companies).
- Pooling of resources: Companies usually bring in different types of assets, technologies, knowledge and expertise.



- **Separate legal status:** The entity formed by a joint venture has separate legal status from the partners in the joint venture.
- **Management:** Partners in a joint venture are usually involved in managing the business.
- **Termination:** A joint venture can be terminated with the consent of all the parties involved.

### ***Advantages and disadvantages of a joint venture***

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>• The risk of launching new products can be shared between partners.</li> <li>• Joint ventures can enjoy economies of scale which results in an increase in production capacity and lower production costs.</li> <li>• Different knowledge and expertise possessed by companies can be used to produce new products, which neither can do alone.</li> <li>• Companies can pool their financial resources together and more capital can be obtained.</li> <li>• Easier entry into new markets</li> </ul>	<ul style="list-style-type: none"> <li>• Disputes among the partners in a joint venture may occur.</li> <li>• It may be difficult to prevent leaks about product information to other partners.</li> <li>• Partners have to discuss matters related to the business with other partners and seek their consent.</li> </ul>

## **Franchise**

A franchise is a business arrangement in which the franchisor allows the franchisee to sell its goods or services. In return, the franchisor receives a franchise fee from the franchisee.

### ***Characteristics of a franchise***

- **Support from the franchisor:** The franchisor provides franchisees with support in the operation of the business.
- **Control by the franchisor:** Franchisees are required to operate their businesses in accordance with the franchisor's instructions.
- **Standardised operation:** The store's look, staff uniforms, logos, products and prices are standardised according to the franchisor's requirements.
- **Sharing of promotional expenses:** The franchisees share the cost of promotional campaigns which are carried out by the franchisor.
- **Well-known brand name:** Most franchisors have built up a good reputation for their products or services.
- **Stores in different locations:** The franchise system operates as a chain with stores located in different areas and cities.



**Advantages and disadvantages of operating a franchise shop**

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>• Franchisees can obtain support from the franchisor.</li> <li>• Franchised stores have built up goodwill.</li> <li>• It is easy to set up the business.</li> <li>• Franchisees enjoy the benefits of a large shop.</li> <li>• The management system of franchised stores helps establish goodwill quickly.</li> </ul>	<ul style="list-style-type: none"> <li>• Franchisees are required to pay promotional and management fees whether or not a profit is earned.</li> <li>• Franchisees may rely too heavily on support from the franchisor.</li> <li>• It is difficult to receive support within a short time if the franchisor’s head offices are located overseas.</li> <li>• Franchisees may not have enough independence in operating their businesses.</li> </ul>

**Public enterprise**

- Public enterprises are enterprises wholly owned by the government.
- There are two types of public enterprises:
  - (i) Government department: Responsible for providing public services such as keeping law and order.
  - (ii) Public corporation: A business organisation incorporated by statute. It is wholly owned by the government but operates on a commercial basis. It has a separate legal existence.

**Characteristics of public enterprises**

- A public enterprise is wholly owned by the government.
- The main objective of public enterprises is to provide services to the general public.

**Advantages and disadvantages of public enterprises**

The following table lists the advantages and disadvantages of public enterprises.

Advantages	Disadvantages
<ul style="list-style-type: none"> <li>• Usually easier to raise fund</li> <li>• Provides public services to the general public</li> <li>• Bridges the gap between the rich and the poor</li> <li>• Avoids wasting resources</li> </ul>	<p><b><i>For all public enterprises</i></b></p> <ul style="list-style-type: none"> <li>Lack of efficiency</li> </ul>
	<p><b><i>For government departments only</i></b></p> <ul style="list-style-type: none"> <li>• Creates financial burdens for taxpayers</li> <li>• Not run on a commercial basis</li> </ul>



### Small and medium enterprises and multinational corporations

Characteristics	SMEs	MNCs
<b>Definition</b>	Firms that are not dominant in their respective business sector.	Enterprises that operate in many countries.
<b>Size</b>	Relatively small in size	Large in terms of assets and revenue
<b>Ownership</b>	Mostly sole proprietorships, partnerships or private limited companies	Mostly listed public limited companies
<b>Management</b>	Mostly run by the owners and their family members	Employ professional managers to run their businesses
<b>Operations</b>	<ul style="list-style-type: none"> <li>• Labour-intensive operations</li> <li>• Use relatively simple technology</li> </ul>	<ul style="list-style-type: none"> <li>• Capital-intensive and technology-based operation</li> <li>• Operations require the application of advanced knowledge and technology</li> </ul>
<b>Finance</b>	Limited sources of funding	<ul style="list-style-type: none"> <li>• More sources of capital</li> <li>• Easier to obtain loans from banks</li> </ul>
<b>Flexibility</b>	<ul style="list-style-type: none"> <li>• Simple organisational structure, flexible operations</li> <li>• Can make changes quickly to satisfy customer demands</li> </ul>	<ul style="list-style-type: none"> <li>• More complex organisational structures and processes</li> <li>• Slow in decision-making and making changes</li> </ul>





## Demo Question

Below is a news item that Yahoo released in June 2007.

Yahoo's shareholders last week voted to replace the existing management team at the shareholders' meeting. Some shareholders had been dissatisfied with the company's lacklustre stock price and its declining performance in recent years. One third of the shareholders were in favour of changing the existing management. They voted to replace the existing management team with a new team. The CEO resigned shortly after the shareholders' meeting and was replaced by Mr Jerry Yang.....

- (a) Identify Yahoo's form of business ownership. (1 mark)
- (b) With reference to your answer in (a),
  - (i) describe the power of the shareholders in the company. (4 marks)
  - (ii) what are the roles of the management and owners in the company? (4 marks)
- (c) Apart from the characteristics listed, list four more characteristics Yahoo may have. (4 marks)



## Troubleshooter

- 1 Apart from reading the financial news, it is important to identify key words in the case study. We can see that "shareholders", "shareholder's meeting" and "stock price" are the key words. It is clear that Yahoo is a public limited company, since an unlimited company has no such features.
- 2 Secondly, we have to locate 'what' and 'who' in the news. Regarding the 'who', we know that there are three actors, namely, the shareholders and the CEOs (both the old CEO and the new CEO). The 'what', is related to the power interaction among the actors, i.e., shareholders and the old CEO. It will be easy to tackle the questions if we understand the context in this way.
- 3 Once the form of business ownership is identified, students will find it easy to tackle the question according to the nature of the form of business ownership. In fact, question (c) asks students the characteristics of a public limited company. Students can answer in terms of the characteristics of a limited company or they may write down some points specific to a public limited company. (A public limited company is a kind of limited company.)





## Answers

- (a) Yahoo is a public limited company. (1 mark)
- (b) (i) Power of the shareholders:
- Shareholders are the owners of a public limited company and can manage the employees of the company, including the top management, i.e., the CEO. (2 marks)
  - In extreme cases, shareholders can force the CEO to resign from the position. They have the power to invite or appoint a new CEO. (2 marks)
- (ii) • In a public limited company, there is usually a separation of ownership and management. (1 mark)
- Shareholders are the owners of the public limited company. They invest in the company and have supreme power in the company. (1 mark)
  - Shareholders are not involved in the daily operation of the company. (1 mark)
  - The CEO is the head of a public limited company and he is involved in its daily operations. He is responsible for devising company strategies and overseeing their implementation but his actions are monitored by the board of directors. (1 mark)
- (c) • Separate legal existence: Changes in shareholders and directors do not affect the running of the company, so it has continuity.
- More sources of capital: Yahoo can raise capital by issuing shares to the public.
  - Limited liability: The loss to shareholders is limited to the amount they have invested.
  - Large scale of business: With more sources of capital, limited companies are usually large in scale. The scale of Yahoo's business is quite large.
  - Disclosure of financial information: Yahoo needs to disclose financial information to the public.
  - Yahoo's share price is affected by many other factors in the stock market, which are not controlled by the company.

(Any other reasonable answers)

(Any four of the above, 1 mark for each point)





## Revision Exercises

### Multiple Choice Questions

(2 marks for each question)

- 1 Which of the following are private enterprises?
- (i) Partnership
  - (ii) Joint venture
  - (iii) Franchise
  - (iv) Public limited company
- A. (i) and (ii)  
B. (iii) and (iv)  
C. (i), (ii) and (iii)  
D. All of the above
- 2 Which of the following concerning forms of business ownership is/are correct?
- (i) An enterprise refers to an organisation that produces and/or provides goods and/or services.
  - (ii) Private enterprises are owned by private individuals.
  - (iii) Public enterprises are owned by the government.
  - (iv) There are two types of limited companies, private limited companies and public limited companies.
- A. (i) and (iii)  
B. (ii) and (iv)  
C. (i), (iii) and (iv)  
D. All of the above
- 3 Which of the following are characteristics of a sole proprietorship?
- (i) If the business fails, the owner may lose his personal possessions.
  - (ii) A sole proprietorship may not be owned by one person.
  - (iii) The scale of the company is usually small.
  - (iv) It is usually managed by the owner.
- A. (i) and (iii)  
B. (ii) and (iv)  
C. (i), (iii) and (iv)  
D. All of the above



- 4 Which of the following are advantages of a sole proprietorship?
- (i) The profits tax rate for a sole proprietorship is lower than that for a limited company.
  - (ii) The ownership of the business can be easily transferred to others.
  - (iii) A sole proprietorship has lower set-up fees when compared with that of other forms of business ownership.
  - (iv) The set-up procedure of a sole proprietorship is simple.
- A. (i) and (iii)  
B. (ii) and (iv)  
C. (i), (iii) and (iv)  
D. All of the above
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- 5 Which of the following are types of partners in terms of their liabilities in a partnership?
- (i) Limited partner
  - (ii) Secret partner
  - (iii) Sleeping partner
  - (iv) General partner
- A. (i) and (iv)  
B. (ii) and (iii)  
C. (i), (iii) and (iv)  
D. All of the above
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- 6 Which of the following concerning the involvement of a partner in a partnership is correct?
- (i) Nominal partners can disclose their identity but they do not take part in running the business.
  - (ii) Secret partners cannot disclose their identity but they take part in running the business.
  - (iii) Active partners invest in the business and also take part in running the business.
  - (iv) Silent partners take part in running the business.
- A. (i) and (iv)  
B. (i), (ii) and (iii)  
C. (ii), (iii) and (iv)  
D. All of the above
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- 7 Which of the following is not a characteristic of a partnership?
- A. A partnership is a legal entity.  
B. The profits tax rate for a partnership in Hong Kong is lower than that for a limited company.  
C. Business risks will not be borne by one person only.  
D. Partners can start their business after signing a Partnership Deed and getting a Business Registration Certificate.
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- 8 Which of the following concerning the characteristics of a limited company is false?
- A. Shareholders do not necessarily run the business.
  - B. A limited company incorporated in Hong Kong is called a private limited company.
  - C. The ownership of a limited company can be divided into shares.
  - D. A private limited company can have 1-50 shareholders.
- 9 Which of the following statements concerning a limited company is false?
- A. The number of shareholders is not limited in a public limited company.
  - B. A private limited company has to disclose financial information to the general public.
  - C. Issuing new shares to the public and raising capital from existing shareholders are two common sources of capital for a public limited company.
  - D. The board of directors may have the power to refuse to register share transfers in a private limited company.
- 10 Which of the following concerning a partnership is false?
- A. Partners are not legally bound by decisions made by any one of the partners in the name of the firm.
  - B. In the case of a limited partnership, there must be at least one general partner with unlimited liability.
  - C. Since the sources of capital available to a partnership are quite limited, the scale of the business is usually small.
  - D. There must be at least two partners.
- 11 Which of the following statements concerning the rights of ordinary shareholders and preference shareholders is false?
- A. Preference shareholders have voting rights.
  - B. Preference shareholders receive dividends before ordinary shareholders are paid and their dividends are fixed.
  - C. Ordinary shareholders have voting rights at annual general meetings.
  - D. Ordinary shareholders may not receive dividends even though the company is making a profit.
- 12 Which of the following concerning a limited company is true?
- A. The shareholders of a limited company have limited liability.
  - B. A limited company is a legal entity.
  - C. Changes in shareholders will not affect the running of the company.
  - D. All of the above.



- 13 Which of the following is not a characteristic of a franchise?
- A. The operation of the shop has to be standardised according to the franchisor's requirements.
  - B. Most franchisors' products are new to the market.
  - C. Franchisees receive support from the franchisor in operating the business.
  - D. Franchisees share the cost of promotional campaigns which are carried out by the franchisor.
- 14 Which of the following concerning small and medium enterprises in Hong Kong is false?
- A. Most SMEs in Hong Kong are sole proprietorships, partnerships or private limited companies.
  - B. SMEs have made important contributions to the economic growth of Hong Kong.
  - C. The proportion of the labour force engaged in SMEs is insignificant in Hong Kong.
  - D. A large number of Hong Kong's business units are SMEs.
- 15 Which of the following is not an example of a public enterprise?
- A. Ocean Park Corporation
  - B. Hong Kong Post
  - C. Hong Kong Shue Yan University
  - D. The Hospital Authority
- 16 A public enterprise
- (i) is wholly owned by the government.
  - (ii) is self-financing.
  - (iii) provides services to the general public.
- A. (i) and (ii)
  - B. (i) and (iii)
  - C. (ii) and (iii)
  - D. All of the above
- 17 The following are recent developments in public enterprises except for
- A. privatisation.
  - B. service expansion.
  - C. outsourcing services.
  - D. setting up trading funds.

18 Which of the following is not a characteristic of multinational corporations?

- A. Some MNCs have moved their production plants to developing countries.
- B. Most multinational corporations are large in size.
- C. Most multinational corporations are public limited companies.
- D. Most of the CEOs in multinational corporations are also the owners.

19 Which of the following concerning a joint venture is false?

- (i) The partners must share profits equally in a joint venture.
  - (ii) There are only two companies in a joint venture.
  - (iii) The companies must pool the same amount of capital to set up a joint venture.
- A. (i) only
  - B. (ii) only
  - C. (ii) and (iii)
  - D. All of the above

20 Which of the following are advantages of running a public limited company?

- (i) Shares can be transferred freely.
  - (ii) There is no upper limit on the number of shareholders.
  - (iii) A public limited company can issue new shares to the public.
  - (iv) There is no need to disclose its financial information to the public.
- A. (i) and (iii)
  - B. (ii) and (iv)
  - C. (i), (ii) and (iii)
  - D. All of the above

21 Which of the following forms of business ownership has limited liability?

- (i) Sole proprietorship
  - (ii) General partnership
  - (iii) Private limited company
  - (iv) Public limited company
- A. (i) and (ii)
  - B. (ii) and (iii)
  - C. (iii) and (iv)
  - D. All of the above



- 22 Which of the following is not a characteristic of a joint venture?
- A. A joint venture is usually formed by two entities.
  - B. A joint venture has separate legal status from the partners in the joint venture.
  - C. A joint venture cannot be terminated even with the consent of all the parties involved.
  - D. Partners in a joint venture are usually involved in managing the business.
- 23 Which of the following is not an advantage of a joint venture?
- A. More capital is available.
  - B. Risk is shared.
  - C. Expertise is shared.
  - D. Private information is shared.
- 24 Which of the following are the benefits of becoming a franchisee of a well-known company?
- (i) No need to have any experience and exposure in business
  - (ii) Receive training and advice from the franchisor
  - (iii) Select raw materials on one's own
- A. (i) and (ii)
  - B. (i) and (iii)
  - C. (ii) and (iii)
  - D. All of the above

### Short Questions

- 1 Operating a franchise shop may have certain disadvantages for a franchisee. However, a franchise is still a very popular form of business ownership.
- (a) List the main advantage for a franchisor in allowing others to sell its goods or services under a franchise arrangement. (2 marks)
- \_\_\_\_\_
- \_\_\_\_\_
- (b) Explain five key advantages in becoming franchisee. (5 marks)
- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_
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- 2 Suggest three reasons why the government of a market-based free economy should have public enterprises. (6 marks)

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- 3 Mr Chan and his brother are a preference shareholder and an ordinary shareholder of ABC bank, respectively. State any three differences regarding their rights and interests. (6 marks)

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- 4 For the past 15 years, Peter has been running his trading company as a sole proprietorship, instead of other more complicated forms of business ownership. Peter is satisfied with this form of business ownership, although the expansion of his company has been limited.

- (a) Give five reasons why Peter started his firm as a sole proprietorship. (5 marks)

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- (b) Why has the expansion of Peter's trading company been limited? Explain in terms of a sole proprietorship's characteristics in raising funds for business growth. (4 marks)

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- 5 Mr Chan is the owner of a small supermarket. He chooses to run his supermarket as a private limited company, instead of a public limited company. However, in order to raise more capital, his friend Louis suggests that Mr Chan should change his supermarket into a public limited company. With more capital, Mr Chan's supermarket has a better chances for business development and can operate on a larger scale.

- (a) Why can a public limited company raise more capital than a private limited company? (4 marks)

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- (b) Mr Chan rejected Louis's idea to turn his company into a public limited company. Give four reasons why you support Mr Chan in running his small supermarket as a private limited company, instead of a public limited company. (8 marks)

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6 Below is an advertisement posted by an accounting firm in a local classified ad.



(a) If the business fails, how much will the owner of (i) a sole proprietorship and (ii) a partnership lose? (4 marks)

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(b) If any of the partners dies, how will the partnership be affected? (3 marks)

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(c) Discuss three advantages the owner can gain from changing his company to a private limited company? (3 marks)

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(d) If any of the shareholders of a private limited company wants to quit, what does he need to do? (2 marks)

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7 Below is a news article concerning Samsung Electronics Co Ltd and Sony Corporation:

**Samsung-Sony venture starts \$1.5 billion LCD line**

Samsung Electronics Co Ltd (a South Korean company) and Sony Corporation (a Japanese company) have set up a joint venture to produce liquid crystal display (LCD) panels. Production will begin at a new \$1.5 billion manufacturing facility. The new production line will use larger 'eighth-generation' (8G) motherglass and produce LCD panels for TV brands, including Samsung and Sony.

28 Nov 2006

(a) What is a joint venture? (2 marks)

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(b) List four benefits for Samsung and Sony in setting up the Samsung-Sony joint venture. (4 marks)

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(c) Forecast four possible problems that could be encountered by the joint venture? (4 marks)

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- (d) In order to avoid future disputes between the two parties, Samsung and Sony will sign a joint venture agreement before they set up the joint venture. List four items to be included in the agreement. (4 marks)

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- 8 Mr Leung has been working as a police officer for 25 years. During his years serving the Hong Kong Police, he has not worked part-time or freelanced in the business sector. With no experience in the business sector, he does not understand much about business operations.

Recently, he has become tired of his work and he plans to retire early. He is thinking of setting up a convenience store, without relying on help from other corporations. He is considering the form of business ownership he should use in setting up the convenience store.

However, his wife suggests that he set up the convenience store with the help of a leading convenience store chain. He is now considering becoming one of its franchisees.

- (a) In your opinion, what are the forms of business ownership that Mr Leung can use to set up his business? *Suggest any 2* (3 marks) 4

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- (b) Explain four unfavourable factors associated with Mr Leung's setting up his convenience store as a franchisee of the leading convenience store chain. (4 marks) 10

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- (c) List four criteria to determine whether Mr Leung should start his business as a franchisee. (4 marks)

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## Chapter 3 Forms of Business Ownership

### Multiple Choice Questions

(2 marks for each question)

- 1 D
- 2 D
- 3 C A sole proprietorship should be owned by one person, according to the legal definition.
- 4 D
- 5 A
- 6 B Silent partners do not take part in running the business.
- 7 A A partnership is not a legal entity as it has no separate legal existence from its owners. For example, if a general partner withdraws, dies or goes bankrupt, the business may close.
- 8 B Every limited company incorporated in Hong Kong is either a private limited company or a public limited company. A private limited company is not equivalent to a limited company.
- 9 B Because of its private nature, a private limited company has no need to disclose financial information to the general public.
- 10 A
- 11 A
- 12 D
- 13 B Most franchisors have built up a good reputation for their products. If the franchisors' products are new to the market, franchisees would not be attracted to them. Because of their good quality, franchisors' products are well-known and recognised by customers.
- 14 C
- 15 C Hong Kong Shue Yan University is a private university and is not owned by the government.
- 16 B Public enterprises include both government departments and public corporations. A public corporation is self-financing but a government department is not.
- 17 B Compared with its peak period, the number of government departments and subsidised agencies is decreasing. Services provided by the government are contracting, instead of expanding. In fact, the principle of public enterprises nowadays is 'small government, big market'.
- 18 D
- 19 D
- 20 C
- 21 C
- 22 C
- 23 D
- 24 A





## Short Questions

- 1 (a) For the franchisor, franchising provides the business with an opportunity to grow, with capital and manpower provided by the franchisees. (2 marks)
- (b) Advantages:
- The franchisee receives a wide range of support in terms of marketing, inventory supplies, accounting and management. (1 mark)
  - Franchise stores have built up goodwill. Their products are well-known and accepted by customers. (1 mark)
  - It is easy to set up the business as the franchisor provides a wide range of support to the franchisees. (1 mark)
  - Franchisees can enjoy the benefits of a large shop, such as lower costs, when the franchisor supplies them with products. The franchisee does not have to spend any effort to source materials or equipment. (1 mark)
  - The management system of franchise stores helps establish goodwill quickly. (1 mark)
- 2 There are reasons why the government of a market-based free economy should have public enterprises:
- Provide services to the general public  
It is the government's responsibility to ensure that some basic necessities are provided to the general public, like water and firefighting services. Therefore, water supplies and fire services departments are set up to fulfil their mission to the general public. (2 marks)
  - Narrow the income gap  
The government should ensure that the basic needs of the poor can be satisfied. Therefore, some departments, such as the social welfare department, provide goods and services to the poor and disadvantaged, so as to narrow the income gap between the rich and the poor. (2 marks)
  - Avoid wasting resources  
The government is able to ensure that there is no duplication and wastage of resources, such as in the provision of railway tracks or water supplies. Resources will thus be allocated more effectively. (2 marks)
- 3
- Ordinary shareholders may earn more dividends when the company earns more profits while the dividends of preference shareholders are fixed. (2 marks)
  - Preference shareholders will receive dividends before ordinary shareholders are paid. In fact, dividends to ordinary shareholders may not be distributed even though the company is making profits if the company wants to use the profits for further investment. (2 marks)
  - Ordinary shareholders have voting rights at the annual general meeting and can elect a board of directors to run the company. Preference shareholders do not have voting rights. (2 marks)
- 4 (a)
- It is much easier to set up because of the simple set-up procedure.
  - The set-up cost is low.
  - The profits tax rate is lower.
  - There is no need to be bound by the decisions of others. Peter can make all the decisions himself. Efficient and flexible operations allow the business to respond quickly to market changes.
  - The relationship with customers and employees can be close.
  - The owner can easily transfer ownership of the business to others.
- (Any five of the above, 1 mark for each point)

- (b) • The sources of capital for a sole proprietorship are quite limited when compared with other forms of business ownership. There is one owner in a sole proprietorship. If Peter wants to raise funds, he can only use his personal savings and retained profits. (2 marks)
- Peter might borrow money from friends, relatives and banks. Peter will have difficulty obtaining loans from banks. In general, banks are unwilling to lend money to sole proprietorships (or SMEs) as their creditworthiness is lower than public limited companies. (2 marks)

5 (a) Reasons:

- One of the main sources of capital for both a private limited company and a public limited company is from their shareholders. As a private limited company, Mr Chan's supermarket can have 1 to 50 shareholders. There is no upper limit on the number of shareholders for a public limited company.
- As a public limited company can raise capital by issuing shares on the stock market, more capital can be raised.
- Because of its higher creditworthiness, it will be easier for a public limited company to obtain loans from banks and make purchases on credit.

(Any two of the above, 2 marks for each point)

- (b) • The company has no need to disclose a lot of company-sensitive information to the public.
- The existing shareholders have better control of the company, since the share transfer is not easy.
  - Less accounting costs on preparing financial statements are incurred.
  - If most of the shares of a public limited company fall into the hands of other parties, existing shareholders may lose control over the company.
  - If the company is listed, the price of the company's shares may be affected by many other factors in the stock market, rather than controlled by the company itself.

(Any four of the above, 2 marks for each point)

- 6 (a) (i) A firm in the form of sole proprietorship has no separate legal existence from its owners. In other words, the owner is personally liable for the debts of the business without limit. (2 marks)
- (ii) • A partnership is not a legal entity. All the partners in a general partnership are general partners and have unlimited liability. The loss for general partners is unlimited. (1 mark)
- In case of a limited partnership, there must be at least one general partner with unlimited liability. The loss for the general partner is unlimited. (1 mark)

- (b) As a partnership is not a legal entity, it does not have a separate legal existence from its owners. This means that the business may close if a general partner dies. (3 marks)

(c) Advantages for an owner to change his company into a private limited company are as follows:

- The shareholders of a private limited company have limited liability, thus they can avoid losing their personal assets.
- It is a separate legal entity. Changes in shareholders and directors will not affect the running of the company, so it has continuity.
- When compared with a sole proprietorship or partnership, it is easier for a private limited company to raise capital, resulting in a better chance for development.
- The size of the business is larger than a sole proprietorship or partnership and so it is able to operate on a larger scale.

(Any three of the above, 1 mark for each point)



- (d) If any of the shareholders of a private limited company wants to quit, his shares can be transferred to others if approved by the board of directors. The board of directors has the power to refuse to register share transfers. (2 marks)
- 7 (a) A joint venture is formed when two or more entities (usually companies) join together and create a new business entity (usually a company) to develop, produce or sell products. (2 marks)
- (b) The benefits gained from setting up a joint venture are as follows:
- Expertise sharing: Both Sony and Samsung are high-technology companies. They can share their expertise in LCD development.
  - More capital: Joint ventures can pool their financial resources together and have more capital to manufacture LCDs.
  - Easier entry into new markets: Sony is a Japanese company while Samsung is a South Korean firm. The setting up of the joint venture may facilitate market entry into the two countries.
  - Economies of scale: The joint venture may increase production capacity rapidly and lower production costs.
  - Sharing risk: The risk can be shared between the two partners in the joint venture.
- (Any other reasonable answers)  
(Any four of the above, 1 mark for each point)
- (c) Possible problems encountered by the joint venture are:
- Disagreement between the two partners: There is a possibility that Sony and Samsung may not be able to work together, due to differences in culture and work styles. (1 mark)
  - Loss of autonomy: Neither Sony nor Samsung can make decisions on its own. This can be regarded as a loss of autonomy. They have to discuss issues related to the business with each other and seek the other's consent. (1 mark)
  - Leaking of information: During the cooperation, it may be difficult to prevent product and company information from being leaked to each others. (1 mark)
  - Less efficient: As many decisions should be made by mutual agreement between the two parties, decision-making in the joint venture may be relatively slow. (1 mark)
- (Any other reasonable answers)
- (d)
- Capital contribution
  - Equity and ownership share
  - Profits and losses to be shared
  - Responsibilities of both parties
  - Nature of the business
- (Any other reasonable answers)  
(Any four of the above, 1 mark for each point)
- 8 (a)
- Mr Leung can own and run the convenience store by himself as a sole proprietorship. (1 mark)
  - Mr Leung can set up a partnership with someone, e.g., his wife. (1 mark)
  - Mr Leung can choose to set up the convenience store as a limited company, so that his property can be separated from that of his company. (1 mark)
- (Any other reasonable answers)

- (b)
- As a franchisee, Mr Leung is required to pay both promotional fees and management fees regularly to the franchisor, whether the shop earns a profit or not.
  - Mr Leung may rely too heavily on the support of the franchisor.
  - Mr Leung may find it difficult to communicate with the franchisor since many head offices of franchisors are located overseas. Mr Leung may not receive support promptly, if problems arise.
  - Mr Leung may not have enough independence in operating his business, such as purchasing or product promotion, as the franchisor has much control over the franchisees' operations.
  - The franchisor has a lot of information about Mr Leung. The franchisor may compete on purpose with the franchisee if Mr Leung's business is successful.

(Any other reasonable answers)

(Any four of the above, 1 mark for each point)

- (c)
- Can Mr Leung afford the franchise fee, promotional and management fees?
  - Does Mr Leung need the support of the franchisor? Can he become more knowledgeable about the business operation? Can he gain the industry knowledge by himself?
  - Can the reputation of the leading convenience store chain attract a lot of customers?
  - Does Mr Leung want autonomy in operating his business?
  - Can Mr Leung communicate and receive support within a short time? Is the franchisor's office located overseas? Will the geographical difference put limitations on his business?

(Any four of the above, 1 mark for each point)