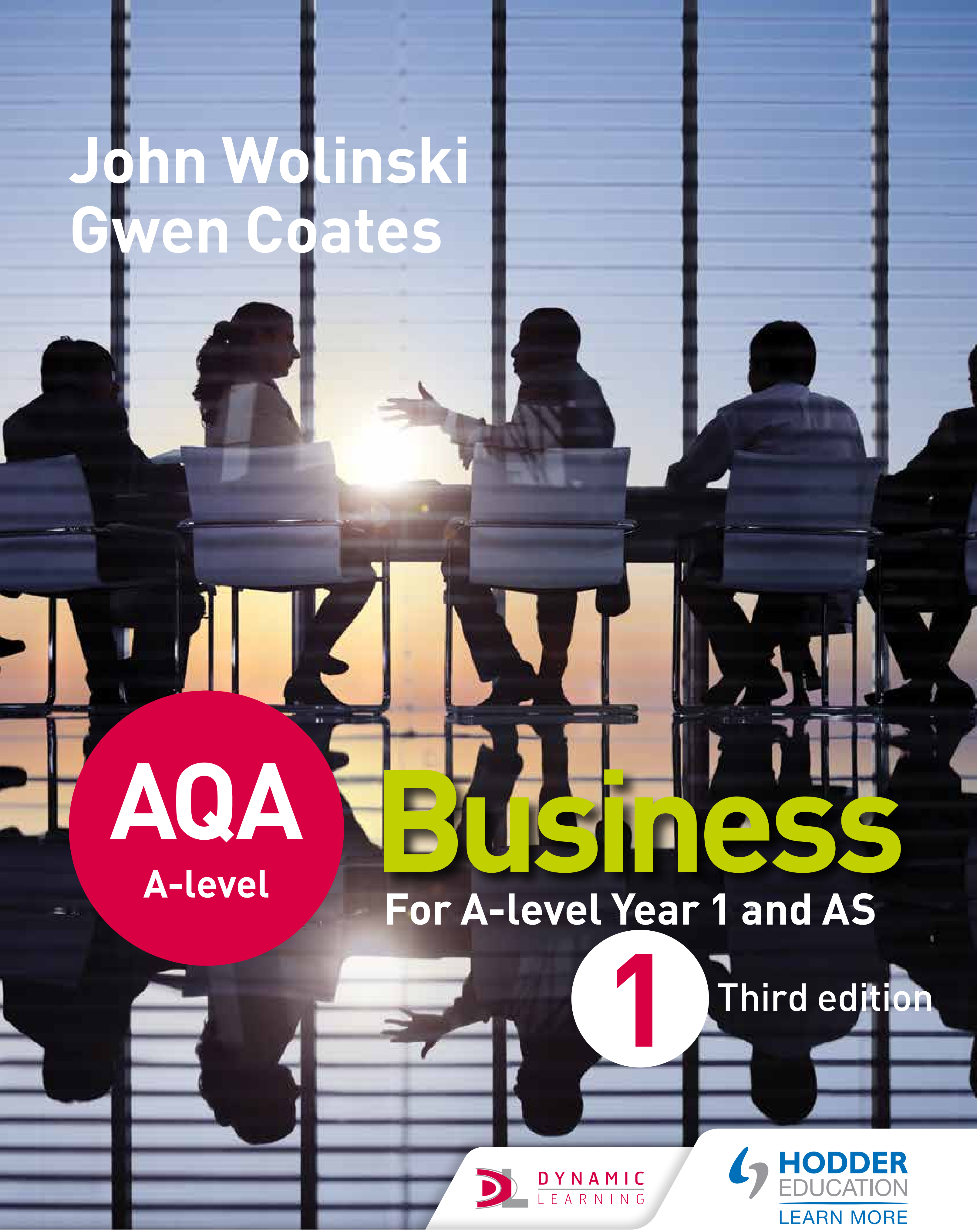

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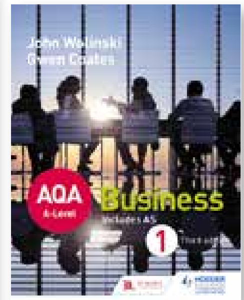

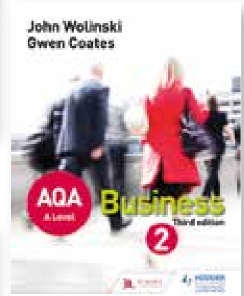

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Contents

2 Understanding different business forms

This chapter focuses on different business forms. It begins with an explanation of the difference between private and public sector organisations. Private sector organisations are then considered in detail. The important concepts of unincorporated and incorporated businesses and of unlimited and limited liability are introduced first, then private sector for-profit organisations are considered, including sole traders, partnerships, private limited companies and public limited companies. In relation to limited companies, consideration is given to ordinary share capital, market capitalisation and dividends. In addition, in relation to limited companies, the role of shareholders and why they invest, and the influences on share price and the significance of share price changes are discussed. A summary of the range of non-profit organisations in the private sector, such as charities and mutual societies, is included. The chapter concludes with a discussion of the effects of ownership on an organisation's mission, objectives, decisions and performance.

The different forms of business

A range of different forms of business exist ranging from very small one-man operations to multinational corporations. Some business forms are set up in order to make profits for their owners and others are established to pursue community or charitable aims. Some business forms operate in the public or governmental sector and others in the private sector. Different business forms are supported by different legal structures that influence how they operate, how they can be financed, what their responsibilities are and what their objectives are.

Private sector and public sector organisations

Private sector organisations are owned, financed and run by private individuals. Organisations in the private sector range from the smallest sole trader business to huge multinational businesses. Although most private sector organisations aim to make a profit, there is a large number of organisations in the private sector that are non-profit organisations, including charities and mutual societies.

Public sector organisations (also known as state-owned or government organisations) are owned and operated by the government, whether at national, regional or local level. These organisations mainly provide essential services, including education, healthcare, police services, refuse collection and street lighting. They are usually provided free at the point of delivery and financed from taxation, for example education and health care. The main aim of public sector organisations is to provide services that would be difficult for individuals to provide for themselves, such as street lighting, or that are deemed essential for all and which some people might not be able to afford to purchase from private sector organisations, such as education or healthcare.

Private sector organisations

The range of business forms (or legal structures) in the for-profit private sector is illustrated in Figure 2.1 below. Each of these business forms is considered in this section and their relative advantages and disadvantages are summarised in Table 2.1 on page 16. A range of business forms that cater for non-profit private sector organisations are considered later in this chapter.

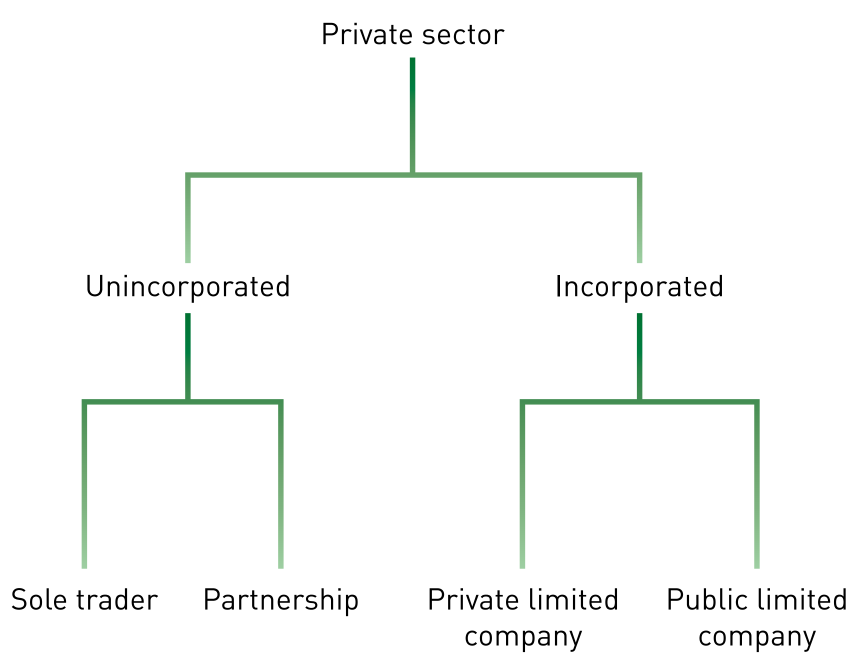
Fact file

At the start of 2013, there were an estimated 4.9 million private sector businesses in the UK. The majority of these (62.6%) were sole traders, 28.5% were limited companies and 8.9% were ordinary partnerships.

Source: Office of National Statistics

Two important classifications to understand when considering different business forms in the private sector are unincorporated and incorporated businesses, and limited and unlimited liability.

Figure 2.1 Legal structures of business in the for-profit private sector



Unincorporated and incorporated businesses

The distinction between **unincorporated** and **incorporated** businesses can be illustrated as follows. If you have a part-time job with Tesco plc, your employer, with whom you have a contract of employment, is Tesco and not the shareholders (owners) of Tesco. If, however, you have a part-time job with the local newsagent, known (say) as Robinson's, which happens to be run as a sole trader by the owner, Mary Robinson, then your employer is the individual who owns the business, Mary Robinson. Similarly, if you had an accident on the premises of Tesco and were advised to sue, then you would sue Tesco plc, not the shareholders (owners) of Tesco. If, however, you had an accident on the premises of Robinson's newsagent, you would sue Mary Robinson, the owner.

Key terms

Unincorporated business There is no distinction in law between the individual owner and the business itself. The identity of the business and the owner is the same. Such businesses tend to be sole traders or partnerships.

Incorporated business This has a legal identity that is separate from the individual owners. As a result, these organisations can own assets, owe money and enter into contracts in their own right. Such businesses include private limited companies and public limited companies.

Unlimited and limited liability

Key term

Unlimited liability A situation in which the owners of a business are liable for all the debts that the business may incur.

Unlimited liability is a characteristic of businesses that are unincorporated, meaning that there is no distinction in law between the owners and the business. If the debts of the business are greater than the personal assets of the owners, they may be forced into bankruptcy. The main types of business with unlimited liability are sole traders and partnerships.

In contrast, if a business with **limited liability** goes into liquidation because it cannot pay its debts, the shareholders (owners) have no responsibility for further payments as long as they have paid in full for the shares they have purchased; their personal assets cannot be used to pay the debts of the business. Legally, such a business has 'died' and so its debts 'die' with it. Limited liability is a feature of incorporated businesses, where the identity of the owners and the business are separate in law. The main

Key term

Limited liability A situation in which the liability of the owners of a business is limited to the fully paid-up value of the share capital. For example, a company issues 200 shares valued at £1 each when it is set up and has four shareholders who each own 50 shares. Each shareholder has paid in full for 30 of their 50 shares. If the company goes bust, the maximum that each of the four shareholders must pay to cover outstanding bills is £20 – i.e. the value of the 20 shares they own but have not yet paid for.

types of business with limited liability are private limited companies and public limited companies. Limiting the amount of shareholders' liability is an important factor in encouraging people to invest because it ensures they know the extent of the risk they face.

Using your knowledge

Ensure that you are absolutely clear about the distinction between limited liability and unlimited liability, so that you do not confuse the two concepts.

Did you know?

Insolvency occurs when the liabilities of a business are greater than its assets and it is unable to meet its financial obligations. Where this happens, it is likely that the business will go into liquidation — i.e. it will turn its assets into cash, for example by selling the firm or its assets, in order to pay creditors. The terms insolvency and liquidation are applied to incorporated businesses with limited liability. For individuals and for unincorporated businesses with unlimited liability, such as sole traders, the situation when liabilities cannot be paid in full is called **bankruptcy**.

Sole trader

Key term

Sole trader A business owned by one person. The owner may operate on his or her own or may employ other people.

A **sole trader** usually has little capital for expansion and is heavily reliant on the owner's personal commitment to make the business a success. Because of its unincorporated status, if the business is unsuccessful, there is no protection from limited liability because the finances of the business are inseparable from those of the owner. Sole traders are most commonly

Fact file

Partnerships

Partnerships are not included in the AQA specification but they are another form of business in the UK. A partnership is a form of business in which two or more people operate for the common goal of making a profit.

There are three main types of partnership:

- An ordinary partnership: partners normally have unlimited liability; a partnership agreement sets out the rights and responsibilities of the partners and how profits will be allocated but in the absence of an agreement, profits are shared equally among all partners; a partnership allows more capital to be used in the business than is the case with a sole trader, and enables the pressures of running the business to be shared, but partners' ability to raise finance remains rather limited.
- A limited partnership: at least one partner assumes responsibility for managing and running the business and has unlimited liability; at least one partner contributes finance, receives a dividend and has limited liability, but has no involvement in the management or running of the business.
- A limited liability partnership (LLP): designed for professional or trading partnerships; allows partners who are actively involved in the business to limit their liability; at least two partners, known as 'designated members', have additional legal responsibilities; LLPs lose the privacy enjoyed by general partnerships in relation to their financial affairs and must register with Companies House, like private and public limited companies.

▲ A sole trader

found in the provision of local services, e.g. newsagents, plumbers and hairdressers.

Private limited company

Key term

Private limited company
A small- to medium-sized business that is usually run by the family or the small group of individuals who own it.

Public limited companies are often the most high-profile business organisations but the significance of **private limited companies** should not be ignored. Most companies are privately owned and they contribute enormously to the economy.

Features of a private limited company

- A private limited company can keep its affairs reasonably private and thus the owners can determine their own objectives without the pressure to achieve short-term profit that is so common for public limited companies.
- Private companies are funded by shares that cannot be sold without the agreement of the other shareholders, which means that their shares cannot be traded on the Stock Exchange.
- The share capital of private companies may be less than £50,000, although many have much higher levels of share capital.
- Private limited companies generally tend to be limited in size.
- A private limited company must have 'ltd' after the company name to warn people that its owners (shareholders) have limited liability.

Fact file

Changing legal structure to suit the circumstances

Samantha Hale has run her sports-products business, Advance Performance UK, as a sole-trading operation, a partnership and a limited company. Samantha started selling sports products in 1996, operating from home. She didn't need outside funding, so being a sole trader seemed the simplest option. When she decided to get retail premises, things grew quickly and the expense of stocking and marketing the shop meant a strain on cash flow. A few months into having the shop, she formed a partnership with her (then) husband, who had a business coaching athletes. Doing that meant that they were able to offset the initial 'start-up' losses from the shop against the profits from the coaching side of the business.

When her marriage and business partnership collapsed, she changed the business to a limited company in order to protect her personal assets.

Samantha won East of England Business Woman Entrepreneur of the Year in 2008, BT Business Essence of the Entrepreneur in 2009 and the Peterborough Evening Telegraph Retail Business Award in 2009 and 2010. Advance Performance UK now has two highly successful Running and Triathlon stores, one in Peterborough and one in Cambridge.

Source: adapted from www.businesslink.gov.uk and www.advanceperformance.co.uk

Fact file

The UK's biggest private limited companies

Each year the Sunday Times publishes Top Track 100, a league table compiled by the research company Fast Track that ranks Britain's 100 private limited companies with the largest sales revenue. Typical Top Track 100 companies have sales between £700m and £2.5bn; are owned and run by established families and entrepreneurs, or owned by private equity companies and managed by senior executives; and have between 500 and 20,000 staff.

The top five companies in the 2013 Top Track 100 league table are as follows (positions in brackets):

- Alliance Boots – retailer and pharmaceutical wholesaler (1)
- Ineos – chemicals manufacturer (2)
- Greenergy – fuel supplier (3)
- John Lewis Partnership – food and general retailer (4)
- Swire – conglomerate (5)

The ownership of these companies varies, for example:

- 45% of shares in Alliance Boots is owned by Walgreens, an American drugstore chain
- 75% of shares in Ineos is owned by Jim Radcliffe, the founder and chairman
- 35% of shares in Greenergy is owned by Tesco
- 100% of shares in John Lewis Partnership are owned by employees
- 67% of shares in Swire are owned by members of the Swire family

Other well-known businesses in the 2013 league table include:

- Virgin Atlantic – airline and tour operator (12)
- JCB – construction equipment manufacturer (14)
- Arcadia – fashion retailer (15)
- Iceland – frozen food retailer (16)
- Thames Water – water services provider (23)
- Specsavers – optical and hearing retailer (24)
- New Look – fashion retailer (30)
- Clarks – shoe retailer and wholesaler (31)
- United Biscuits – branded snack manufacturer (32)
- Phones 4U – mobile telephone retailer (38)
- Findus Group – food producer (39)
- Matalan – value retailer (42)
- River Island – fashion retailer (49)
- Dyson – appliance manufacturer (51)
- Formula One – motor racing administrator (62)
- Virgin Trains – train operator (66)
- Poundland – discount retailer (76)
- Odeon and UCI Cinemas – cinema operator (86)
- Harrods – department store operator (94)
- House of Fraser – department store operator (95)

Source: adapted from www.fastrack.co.uk (2014)

Public limited company

The shares of **public limited companies** are traded on the Stock Exchange, which enables these businesses to raise finance more easily. Private limited companies sometimes change to public limited companies, usually to obtain extra funds for growth. However, 'going public' has disadvantages:

- It involves a loss of control, as the business moves away from the ownership and support of a family or close-knit group of individuals, and becomes responsible to shareholders, including institutional investors.
- It subjects the business to constant scrutiny by the financial press.
- It may cause the business to focus on short-term profits for shareholders and maintaining share prices in order to avoid takeover pressure, which detracts from long-term decision making.

These disadvantages are such that a number of large, successful private limited companies resist becoming public limited companies, while other successful public limited companies revert back to private limited company status. The number of public limited companies listed on the London Stock Exchange has declined from over 2000 in 1998 to just over 1000 in March

Key term

Public limited company A business with limited liability; a share capital of over £50,000; at least two shareholders, two directors, a qualified company secretary; and, usually, a wide spread of shareholders. It has 'plc' after the company name.

2014. Well-known companies that have reverted from public to private limited company status include Arcadia, Selfridges, New Look and Pizza Express.

▲ Pizza Express is one company that has reverted from public to private limited company status

Few of the companies that ceased trading as public limited companies did so because of financial failure. Most chose to go private for a number of reasons, including the excessive cost of meeting the regulatory requirements for public limited companies, the continual dissection of public limited companies' performance by market analysts, and the relative privacy of the private limited company structure. A sharp rise in the amount of capital available to private companies is a major reason for the decline in the number of companies becoming public limited companies. Another key advantage of joining the stock market – share liquidity – has also become less persuasive and, indeed, is sometimes regarded as unnecessarily risky because predators can easily snap up shares and put pressure on management to make changes it may not agree with.

Using your knowledge

As both private limited companies and public limited companies are incorporated businesses and have limited liability, ensure that you are clear on the distinction between them and do not confuse them when you answer questions on this topic.

Did you know?

Institutional investors are pension funds, insurance companies, banks and other financial organisations that invest huge sums of money in the shares of public limited companies quoted on the Stock Exchange. They invest on behalf of others, for example, investing the funds employees pay into their pensions. Institutional investors are by far the largest group of investors in company shares and therefore have huge influence on companies. Critics suggest that it is pressure from institutional investors seeking to maximise their funds and profits, that forces businesses to focus on short-term profits (known as short-termism) rather than on long-term performance.

Using your knowledge

Ensure that you understand the effect that becoming a public limited company with a quotation on the Stock Exchange can have on a company, as this can be a crucial factor for a company that wants to grow.

▲ The Stock Exchange

Fact file

Stock Exchange listings

When a public limited company wishes to raise finance, it does this by issuing (selling) shares to the public. This is done by an IPO (initial public offering), which is the first sale of shares by a private company to the public. IPOs are issued by smaller, younger companies seeking the capital to expand or by large privately owned companies, wishing to become public limited companies. Once shares have been issued in this way, the owners can sell them on the Stock Exchange. The Stock Exchange is therefore a market where second-hand shares (i.e. shares that have already been issued to the original shareholders) of public limited companies can be bought and sold. The public limited company itself is not involved in stock exchange trading, but will just change its records so that any dividends due on the shares are paid to new owners. The Stock Exchange assists companies in raising finance because people would be more reluctant to buy shares if they could not easily offload them when required.

Fact file

Private Equity Firms

In recent years, private equity takeovers have played an important part in UK business. Private equity firms are made up of private investors who take over a company and work closely with the managers to turn the business around. Their aim is to make it profitable and then sell it. Therefore, they look for businesses that are undervalued and can be improved. Private equity firms often buy public limited companies, convert them into private limited companies, improve them and then sell them back to the public.

When public limited companies are listed on the Stock Exchange, managers often find that investors are interested only in short-term rewards. This can make it difficult to invest in longer-term projects or take risks. Radical or innovative decisions may be shelved in favour of more conservative choices. Reporting to many different investors also takes up a lot of management time. When a private equity company takes over a public limited company, it often empowers the managers to run the business and make the right decisions, even if they are risky or take years to pay off. The private equity firm is closely involved in the running of the business and in developing the right strategy.

However, private equity takeovers are usually financed by debts, so they carry a high risk. Some private equity firms have been accused of being asset strippers — buying a company to squeeze out whatever profit they can get before selling it on. In general, private equity is perceived as representing the short-term interest of between two and five years — quite different from the longer-term perspective taken by most family-based private limited companies.

Table 2.1 Advantages and disadvantages of different legal structures

Structure	Advantages	Disadvantages
Sole trader	• easy and cheap to set up • few legal formalities • able to respond quickly to changes in circumstances • owner takes all the profit and hence there is good motivation • independence • more privacy than other legal structures, as financial details do not have to be published	• unlimited liability • limited collateral to support applications for loans • limited capital for investment and expansion • difficulties when the owner wishes to go on holiday or is ill • limited skills as the owner needs to be a 'jack of all trades'
Private limited company	• limited liability and the business has a separate legal identity • access to more capital than unincorporated businesses • more privacy than a plc, as it is only required to divulge a limited amount of financial information • more flexible than a plc	• shares are less attractive, as they cannot be traded on the Stock Exchange and hence could be difficult to sell • less flexible if expansion needs finance, which is more difficult to raise than for a plc • there are more legal formalities than for an unincorporated business
Public limited company	• limited liability and the business has a separate legal identity • easier to raise finance as a result of its Stock Exchange listing • greater scope for new investment • can gain positive publicity as a result of trading on the Stock Exchange • suppliers tend to be more willing to offer credit to public limited companies	• must publish a great deal of financial information about its performance • greater scrutiny of activities • significant administrative expenses • founders of the firm may lose control if their shareholding falls below 51% • a stock exchange listing means pressure from investors may lead to more emphasis on short-term financial results, not long-term performance

Ordinary share capital

Ordinary share capital is a term used in relation to private and public limited companies. Ordinary shares are known as risk capital or equity capital. A shareholder owning 1% of a company's ordinary shares receives 1% of any profit given to ordinary shareholders as **dividend**, and gets 1% of the votes at the annual general meeting (AGM). There is no guaranteed level of dividend and sometimes no dividend at all is paid. This is because people who are owed money by the business must be paid first and even in profitable years, profits may be ploughed back into the business to finance further improvements rather than distributed to shareholders. More detail on ordinary share capital is provided in Chapter 18 ('Making financial decisions: sources of finance'). Because ordinary shareholders are usually

Key term

Ordinary share capital
Money given to a company by shareholders in return for a share certificate that gives them part ownership of the company; ordinary share capital is permanent, so a business will never be required to repay the value of these shares to their owners.

Key term

Dividends Payments made by companies to their shareholders out of profits earned. When a company earns a profit or surplus, it can either reinvest it in the business or it can distribute it to shareholders or allocate a proportion to reinvestment and a proportion as dividends. High growth companies rarely offer dividends because all of their profits are reinvested to help sustain higher than average growth. Dividends are allocated as fixed amounts per share, with shareholders receiving a dividend in proportion to their shareholding.

given one vote for each share, ownership of 51% of the shares in a company guarantees overall control of that company.

Fact file

Lloyds Bank and dividend payments

In the first quarter of 2014, Lloyds Banking Group's pre-tax profits improved by over 20%. This was a result of falling costs due to job cuts and its withdrawal from many of its international businesses. The improved profit strengthened the bank's plan to pay its first dividend since it was rescued during the financial crisis.

Before the financial crisis Lloyds had a record of being one of the companies paying the highest dividend shares in Britain, paying out just over half of its profits in dividends in 2005 and 2006. Following the financial crisis, the government pumped in £20 billion to keep Lloyds afloat, giving the British taxpayer a 41% stake in the business. The Group has not paid a dividend on shares since the financial crisis.

Market capitalisation

Key term

Market capitalisation The value of outstanding shares in a public limited company. Outstanding shares are the total of all ordinary shares issued and fully paid up. Market capitalisation is calculated by multiplying the total outstanding shares by the current market price of an individual share.

Note: the value of a public limited company's ordinary share capital is not the same as its market capitalisation.

Market capitalisation (or market cap) is the total value of the issued ordinary shares of a public limited company. It is calculated by multiplying the current market price of an individual share by the number of issued ordinary shares. For example, if a company has issued 25 million ordinary shares and the current market price of its ordinary shares is £10, the company's market capitalisation is £250 million (25,000,000 x £10 per share). Market capitalisation is therefore influenced by the number of shares issued and the market price of shares. Market capitalisation is often used as an indication of investors' opinion of a company's net worth or its overall value.

The value of ordinary share capital uses the price of shares at the time they were first issued – i.e. the value that initial investors paid for them, not the current market price, which is the value used in market capitalisation.

For example, if a company issues 100,000 ordinary shares at £2 each in May 2014, its ordinary share capital will be £200,000. By December 2014, its share price, as quoted on the Stock Exchange might be £5 each. Assuming all shares were sold and are fully paid up, its market capitalisation will therefore be £500,000 but its share capital is still £200,000.

The role of shareholders and why they invest

Key term

Shareholder The owners of a limited company; any person, company or other institution that owns at least one share in a company.

Shareholders are the owners of companies. A small business may have just one shareholder, the founder, while a public company may have many thousands of individual and institutional shareholders. People invest in shares for a variety of reasons:

Fact file

Shares in Royal Mail

Since making its debut on the London Stock Exchange in October 2013, the price of shares in Royal Mail has risen strongly. Experts suggest that there are two compelling reasons to hold onto the shares:

1. Royal Mail will pay out its first dividend in July 2014. For those who bought shares when they were first issued, it means a return on their investment per share of over 6%.
2. The company is viewed as a solid long-term bet as demand for parcels is expected to boom rather than decline and thus share price is expected to continue to rise.

▲ Eurostar train at Waterloo station

- to provide financial support for a business and to be involved in the running of a business. Shareholders of private limited companies will usually have this motivation
- to gain control of a business, which they can do by buying up 51% of shares. This may happen to a public limited company because its shares are traded on the Stock Exchange and are therefore available for anyone to buy
- for the regular dividend they will receive if the company makes a profit and decides to distribute a portion of this to shareholders
- to make a capital gain, i.e. to profit from the price at which they buy a share and the price at which they sell it at a later date.

Fact file

The Channel Tunnel

Groupe Eurotunnel, also known as the Eurotunnel Group, is a company listed on the Paris and London stock exchanges. Its core business is the operation of the cross-Channel Fixed link (i.e. the Channel Tunnel). Its share capital of €220 million is made up of 550 million fully paid up ordinary shares with a nominal value of €0.40. Its share price in March 2013 was €6.5 and in March 2014, it was €8.55. Market capitalisation in March 2014 was therefore approximately €4.7 billion (number of fully paid up ordinary shares x current share price). Dividends per share have increased in each of the last four years from €0.04 in 2010 to €0.15 in 2013.

This data indicates the type of return on investment an average shareholder might gain. An investor buying shares in March 2013, when share prices were €6.5 and selling them in March 2014 would have made a capital gain of just over €2 per share (i.e. a capital gain of 31.5% on their original investment - €2.05 increase in share price as a percentage of the initial share price of €6.5). In terms of dividends, an investor buying a share in March 2013 at €6.5 received a dividend of €0.15 at the end of the year, giving a return of 2.3% (i.e. the dividend of €0.15 as a percentage of the share price paid of €6.5).

Source: Adapted from Group Eurotunnel Annual Review and Corporate Social Responsibility Report 2013

Did you know?

There is no statutory requirement to hold an annual general meeting if the company is a private limited company, however the shareholders may request that one is held or the directors may call an annual general meeting if desired. Under the Companies Act 2006 public companies must hold an annual general meeting.

Shareholders have a number of important functions and have certain rights:

- One of the primary reasons for shareholders is to provide finance for a business. Issuing shares enables a business to raise funds for expansion or development. In return, the company's founders give up part ownership to new shareholders.

- The majority shareholder, i.e. the one that owns at least 51% of ordinary shares will be in a position to influence the decisions taken by the organisation's management.
- Although the majority of shareholders in a public limited company do not play a major role in running the company, they do have a right to vote on resolutions at annual general meetings. These might include who sits on the board of directors, whether a proposed merger should go through or whether the level of directors' bonuses is appropriate. (Note: directors are also likely to be shareholders).
- Shareholders have the right to inspect the company's books and records.
- Shareholders have a right to receive a portion of any dividends the company declares. If the company liquidates, they have the right to a share of the proceeds. However, creditors, bondholders and preferred shareholders have precedence over ordinary shareholders in the event of liquidation.

Influences on share price and the significance of share price changes

Did you know?

Stocks and stockholders are American terms for shares and shareholders. The term stock is used widely in other related terms, including stockbrokers (people who offer advice and buy and sell shares for clients), the Stock Exchange, the stock market.

Key term

Share price The price of a single share in a company; share prices are usually determined by the supply and demand for shares.

The price at which ordinary shares trade will have nothing to do with their original value, but will be determined mainly by market forces i.e. by supply and demand. If more people want to buy a share (demand) than want to sell it (supply), then the price moves up. Conversely, if more people want to sell a share than want to buy it, there would be greater supply than demand, and the price would fall. In addition to market forces, the extent to which prices in general increase over time (known as the inflation rate) will influence **share prices**, particularly over the very long term.

Did you know?

In general, the price movement of a share indicates the level of investors' confidence in a company. However, a company's performance, for example in terms of the profits it makes, is not necessarily a reflection of its share price. This is because market capitalisation, an indication of a company's value, is the share price multiplied by the number of shares issued. During the dotcom bubble, for example, many internet companies had market capitalisations in the billions of pounds without ever having made any profit. History indicates that these valuations were not sustained and most internet companies saw their values shrink to a fraction of the value they reached at the height of the dotcom bubble.

Many factors influence the supply and demand for shares. Some of the main factors include:

- The state of the economy. If economic conditions are good and are expected to continue, investors tend to feel confident. Companies are more likely to perform well, make larger profits and thus are more likely to pay higher dividends. Under such circumstances, demand for shares tends to rise and thus share prices increase. However, if economic conditions are difficult, investors may feel nervous. They may worry that a company's profitability will decline and this will tend to reduce the demand for shares, which may cause share prices to fall.
- The performance of the company. If a company is performing well, and is expected to continue to do well, its share price is likely to rise. When a company reports good profits, investors have more confidence in it and there is more demand for its shares, which increase in price. Conversely when a company reports lower profits, investors lose confidence in the company and sell their shares, which is likely to lead to a reduction in their price.
- Competition in the market. This is closely linked to the above point because how well a business responds to the threat of competition in the market in which it operates will influence how well it performs overall and in particular its profitability.
- Proposed takeovers. A takeover is when one company makes an offer to take control of another company by buying enough shares to ensure it has the power to influence policy, make decisions and elect directors. Shareholders in the company being targeted for a takeover usually receive an offer to buy their shares (either for cash or for shares or a combination of both) from the company planning the takeover. They can accept or reject the offer. The prospect of a takeover can influence the price of shares and will reflect whether investors think the takeover bid is likely to succeed. The potential and actual impact of takeover bids on share prices is the focus of regular discussions in the financial press.
- Investors' expectations and their response to rumours. When people see that others are selling their shares in a particular company for whatever reason – perhaps because they have heard a rumour that it is struggling and in danger of going into liquidation – more people will want to 'get on the bandwagon' and sell their shares. This will cause an increase in supply of these shares and with little demand for them, the price of the shares will fall, perhaps significantly, as people are desperate to get rid of them before their price falls even further. A similar process in the opposite direction happened to internet companies in the dotcom bubble period. Shares in these companies were tremendously popular, plenty of people wanted to buy them, the number of shares on the market was limited to those issued by the company in the first place. In order to get shares, the price was bid up. People saw these share prices rising and more people wanted to own them. Prices went up further. And so on.

Although average share prices show a long term upward trend, individual share prices are extremely volatile and can change extremely rapidly. This is why for individual savers, investment in shares should be viewed as a long term activity over many years.

Reasons for choosing different forms of business and for changing business form in the private sector

A number of factors affect the choice of business form or legal structure in the private sector. These have been discussed within the previous sections about each type of business organisation. To summarise, they include the need for finance in order to expand; the size of the business, and the level and type of investment required; the need for limited liability; the degree of control desired by the original owners; the nature of the business and its objectives; and the level of risk involved. For example, a manufacturing business requiring heavy investment in plant and equipment before anything can be sold may need limited liability in order to raise sufficient funds. On the other hand, a business that requires much less investment and therefore very little borrowing will involve relatively little financial risk, and there may be no need for limited liability. In other cases, image might be vitally important and the word 'ltd' after a name may add status, and 'plc' even more so.

Non-profit organisations

Non-profit organisations do not have a defined structure and such organisations can take many different business forms. Such organisations are also known as the third sector (because they are not part of the for-profit private sector or the public sector). This sector includes voluntary and community organisations, charities, social enterprises, pressure groups, trade unions, cooperatives, mutual societies and trusts.

▲ Christian Aid is a non-profit organisation

Although **non-profit organisations** vary, they share the following common characteristics:

- They are non-governmental organisations.
- They have a governing body responsible for managing their affairs.
- They are value driven and have social, environmental, community, welfare or cultural aims and objectives.
- They are usually established for purposes other than financial gain, with any profits or surpluses being reinvested in the organisation in order to further its objectives.
- Many use volunteer staff in addition to paid employees.
- These organisations may make profit, but their objective is not to maximise profit for their shareholders and owners. They can operate under a number of different legal structures, including charities, trusts, mutuals and companies limited by guarantee.

Except for the distinguishing feature that non-profit organisations do not distribute profits to their owners, many such organisations have much in common with for-profit organisations. For example, while some non-profit organisations use only volunteers as employees and as managers and directors, any sufficiently large non-profit organisation is likely to require a permanent staff of paid employees, as well as highly skilled managers, and directors. Many large non-profit organisations wish to accomplish their objectives in the same way as for-profit enterprises, so the same business tactics and management techniques as in the for-profit sector are used.

Fact file

Industrial and Provident Societies (IPS)

Industrial and Provident Societies (IPS) are incorporated organisations whose members benefit from limited liability. These types of organisations are often known as **mutual societies**. An IPS is owned and democratically controlled by its employees and members. A mutual exists with the purpose of raising funds from its members or customers, which can then be used to provide common services to all members of the organisation or society. Examples of this type of organisation in the UK are co-operative societies, mutual insurance companies and building societies. Instead of having shareholders, building societies have members who collectively own the business and are also its customers. Members have the right to vote for directors regardless of how much or how little money they have with the society.

Did you know?

The 1980s and 1990s saw many long established building societies 'demutualise' by converting to, or merging with, banks, which are public limited companies. As a result there are now less than 50 building societies. The largest is Nationwide Building Society.

Fact file

Companies limited by guarantee

Non-profit organisations can be unincorporated or incorporated. In the UK, many non-profit organisations are incorporated as companies limited by guarantee rather than limited by shares. The organisations do not have shares or shareholders, but benefit from being incorporated, which includes limited liability for its members and being able to enter into contracts and purchase property in its own name. The profits of the company (known as the trading surplus) must be invested in achieving the goals of these companies and not distributed to the company's members. By taking up limited liability status, a charity limits the liability of its management or trustees in respect of any financial losses that it may sustain. The directors of the organisation give a nominal guarantee (usually of £1), and are not personally liable for any losses beyond that amount. Examples of non-profit organisations that are companies limited by guarantee include: Shelter, the charity that helps homeless people; and Amnesty International, the human rights campaigning organisation.

Did you know?

Community Interest Companies

The Companies Act 2006 introduced a new form or organisation known as a Community Interest Company. These are limited companies with special additional features and are created for use by people who want to conduct a business or other activity for community benefit, rather than private advantage. The assets and profits of these companies are intended to be used for the public good.

The effects of ownership on mission, objectives, decisions and performance

Just as a variety of factors affect the choice of business form, so the choice of business form influences the ownership of a business. This in turn influences the organisation's mission and objectives, its decision-making processes and ultimately will have an impact on its performance.

The mission and objectives of public sector organisations are generally focused on meeting social needs and providing essential services. For example, the mission of a Midlands-based teaching hospital is 'We will be a leading centre in healthcare driven by excellence in patient experience, research, teaching and education'. Decision-making in public sector organisations will reflect this focus on meeting social needs and providing essential services. As a result, sometimes activities that are not profitable to provide, for example local libraries, are nevertheless still provided in some areas because local authorities judge that the benefits they provide for the local population outweigh the costs of providing them. These organisations may not have to return maximum profits to shareholders, but they do have to provide good value for money for citizens. As a result, just as in the private sector, strong leadership of public sector organisations is essential to ensure effective decision-making, tight financial management and efficiently run operations.

Did you know?

Prior to the 1980s, many major industries including gas, water, electricity, telecommunications, coal and rail transport – were provided by **nationalised industries**. These were state-run industries, owned, financed and operated by government. The argument was that this was a more efficient way of running these industries. This was based on the view that these industries were natural monopolies, that is, industries that were not only essential to the economy and people's lives, but could be run more efficiently if operated by a single owner rather than a range of competing firms. In the 1980s, under Prime Minister Margaret Thatcher, this view was challenged and most nationalised industries were privatised. The view was that the private sector was more efficient, innovative and dynamic and that competition would lead to reduced costs and prices and improved quality and service. **Privatisation** meant that shares in the nationalised industries were sold to the private sector. These organisations are now run by competing private sector companies, owned by shareholders.

The mission and objectives of non-profit organisations, although not focused on maximising profits for their owners or members will be focused on generating sufficient profit or surpluses to reinvest in their particular field of interest. Examples of mission statements of non-profit organisations already mentioned in this chapter are:

> Shelter: 'Shelter believes everyone should have a home. Our work won't stop until there's a home for everyone.'

> Nationwide Building Society: 'We exist solely for the benefit of our members. We help them and their families meet their financial needs in a sustainable, responsible and secure way.'

As for all organisations, non-profit organisations need strong leadership and well-trained staff to ensure their operations are as efficient as possible to enable them to perform effectively and achieve their objectives.

Apart from non-profit organisations, most private sector organisation aim to make maximum profit for their owners. However, this is not the only objective as the following extracts from mission statements illustrate.

> JCB: 'We will support our world-class products by providing superior customer care. Our care extends to the environment and the community.'

Tesco: '... to create value for customers to earn their lifetime loyalty'.

Google: '... to organise the world's information and make it universally accessible and useful'.

Thus although for-profit private sector organisations must ensure they make sufficient profits to reinvest in their businesses and to satisfy their owners, they may also pursue other objectives, for example promoting long term growth or developing a strong reputation for environmental and ethical standards.

In the case of sole traders, partnership and private limited companies, their owners usually have a significant role in the management and leadership of the business. When these businesses begin to expand, their ownership often changes and this can have significant effects on the missions and objectives of a business and how it makes decisions. A sole trader that expands by becoming a partnership may benefit from additional expertise and finance but the original owner will have to take the views and expectations of partners into account, which requires a very different approach to decision-making. The eventual impact on the performance of the business will depend on how well these changes are planned for and handled. Similarly, bringing new shareholders into a small private limited company can add further expertise and increase the finance available, but new shareholders may not have the same values and aims as the original owners. The proportion of shares held by the original owners may decline and they may ultimately lose overall or effective control of the business. As a result, the original mission of the business may change considerably. As mentioned above, how these changes impact on the performance of the business will depend on how well a change in ownership is planned for and how well the change is managed.

In public limited companies, the vast majority of owners of the company, the shareholders, are not involved in the management and leadership of the company, which can lead to tension. Shareholders may want the business to pursue strategies that bring short term gains to profits and to share prices, while managers and leaders may prefer to pursue strategies that lead to the longer term success of a company, which may mean lower profits in the short and medium term. (More discussion of this point about the 'divorce of ownership and control' will be covered in Chapter 18 in Book 2.)

Practice exercise

Total: 60 marks

1 Explain the implications for someone starting a business without having limited liability. *(4 marks)*

2 Explain one advantage and one disadvantage of a sole trader as compared with a partnership. *(6 marks)*

3 Distinguish between a private limited company and a public limited company. *(6 marks)*

4 Explain one advantage and one disadvantage of a private limited company over a public limited company. *(6 marks)*

5 Which one of the following business forms is likely to be most suitable for a non-profit organisation?
   a) sole trader
   b) public limited company
   c) private company limited by guarantee *(1 mark)*

6 Company A has 5 million ordinary shares that were issued at a price of £5 each. The current market price of each share is £50. Calculate Company A's market capitalisation and explain why this differs from its ordinary share capital. *(7 marks)*

7 Explain two reasons why people might decide to invest in shares. *(6 marks)*

8 Identify and explain two factors that might influence the price of shares. *(6 marks)*

9 Identify and explain three factors that are likely to influence the choice of legal structure. *(9 marks)*

10 Identify and explain three effects of different business ownership on a company's mission and its objectives. *(9 marks)*

Case study: Staying private

A number of large, high-profile, public limited companies have made the decision to revert back to private limited company status in order to reduce media scrutiny and pressure and the accompanying emphasis on short-termism. Other expanding companies have made the decision to remain as private limited companies.

William Timpson opened his first shoe shop in 1865. In 1912, WM Timpson became a private limited company and converted to a public limited company in 1929. It was eventually bought by United Drapery Stores (UDS), a retail conglomerate, which was in turn acquired by Hanson Trust, a multi-industry conglomerate, in 1983. At this point, the Timpson family bought the company back and focused on shoe repairs rather than shoe sales. In 2003, the family-owned shoe repairer bought the Minit Group, which owned Sketchley cleaners, Supasnaps and Mister Minit. In 2009, it bought Max Spielmann photo stores, based mainly in the North of England. This was complemented by its acquisition early in 2013 of Snappy Snaps, the franchise photo chain based mainly in London and the South East. Timpson now controls more than 900 retail outlets nationwide.

John Timpson, the group's chairman, is the great-grandson of the original founder of the business, William Timpson. John Timpson is quoted as saying, 'We only have one firm plan, which is that we will not float the business. We think staying private is the best way to run the business.' He says that most months he is approached by bankers keen to buy shares in the business and help it expand. His response is that he prefers to fund expansion from cash flow, that is, from money generated within the business. He says he would never float the business and 'would hate going around the City having shareholders telling me what to do.'

Source: adapted from an article in the Financial Times, May 2003 and websites www.timpson.co.uk and www.timpson.co.uk/blog (2014)

Questions

Total: 60 marks

1 At various times in its history, Timpson has been a sole trader, a private limited company and a public limited company. Evaluate how appropriate the sole trader and public limited company business forms might have been as the business grew and developed. *(20 marks)*

2 For some of its history, Timpson was a public limited company. Analyse the factors that might influence the share price of a public limited company in a similar market to Timpson and evaluate the factors that would persuade an investor to buy shares in a company like Timpson. *(20 marks)*

3 Discuss the factors that John Timpson might have taken into account in judging that 'staying private is the best way to run the business'. *(20 marks)*

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