FORMS OF OWNERSHIP

2 PAPER

2 TOPIC

Explain the meaning of limited liability and unlimited liability.

LIMITED LIABILITY	UNLIMITED LIABILITY
Losses are limited to the amount that the owner invested in the business.	The liability of the owners to pay debts/claims is not limited to the business only.
The owner's personal assets are protected against the debts of the business.	The owner's personal assets may be seized to pay for the debts of the business.

Criteria that will be used to evaluate the success and/or failure of forms of ownership

- **Taxation:** The tax requirements of each form of ownership determine the impact of taxation on business success/failure.
- **Management:** Ownership impacts on management functions which determine the success/failure of the business.
- **Capital:** refers to the ability to obtain capital from various sources (e.g., own/borrowed capital). The amount of capital that can be sourced will also impact on business success/failure.
- **Division of profits:** refers to how profit is divided between owner(s)/shareholders/ investors.
- **Legislation/Legal requirements** for establishment/starting a business impact on the establishment costs and time before a business can legally do business.

SOLE TRADER

Characteristics (4)

- The owner has a personal interest in the management and the services that is rendered.
- It is easy to establish as there are no legal formalities in forming the business
- There are no legal requirements regarding the name of the business.
- The owner has unlimited liability

Impact (4)

- ✚ Owner makes all decisions.
- ✚ Requires little capital to start.
- ▪ Unlimited liability which means the owner is responsible for all debts incurred.
- ▪ Cash flow is often a problem

Factors that contribute to the success and/or failure of a sole trader

	SUCCESS	FAILURE
Taxation	Owner only taxed on profits in personal capacity.	If profits get too big may end up paying high tax in personal capacity.
Management	Managed/Controlled by the owner who has a direct interest in the success of the business .	Lack of adequate business management skills/knowledge may lead to business failure.
Capital	Capital can be carefully spent and managed	Profits may not be large enough for expansion.
Division of Profits	Owner receives all profits from the business which can lead to capital growth.	Owner needs to budget carefully so that business debts are covered
Legislation	It is easy/inexpensive to start.	Unlimited liability may discourage owners if the business struggled to pay off its debts.

PARTNERSHIP

Characteristics (4)

- An agreement between two or more people who combine labour, capital and resources towards a common goal.
- Partners combine capital and may also borrow capital from financial institutions.
- No legal requirements regarding the name of the business.
- Profit is shared according to the partnership agreement

Impact (4)

- ✚ The workload and responsibility is shared between partners.
- ✚ Partners are able to share resources.
- ▪ A partnership has unlimited liability
- ▪ Partners might not all contribute equally

Factors that contribute to the success and/or failure of a partnership

	SUCCESS	FAILURE
Taxation	The partnership does not pay income tax, only the partners in their personal capacities	High-earning partners pay more tax, which may discourage other partners from joining the partnership.
Management	Not all partners need to be actively involved in management and would rather appoint competent managers.	Decision making can be time-consuming as all partners have to be in agreement
Capital	More than one partner contributing to capital.	Partners may not all have capital to put into business when needed
Division of Profits	Partners share profits according to their contributions.	Amount of work done may not be equal to the amount of profit that each partner receives.
Legislation	Easy and cheap to establish, as partners must draw up partnership agreement.	Unlimited liability/ partners are jointly and severally liable for the debts of the business.

PRIVATE COMPANIES

Characteristics (4)

- Requires one or more directors and one or more shareholders.
- The company name ends with letters (PTY) Ltd.
- A private company is not allowed to sell shares to the public.
- Raises capital by issuing shares to its shareholders

Impact (4)

- ✚ More opportunities to pay less taxation.
- ✚ Good long-term growth opportunities.
- ▪ Requires a lot of capital.
- ▪ More taxation requirements

Factors that contribute to the success and/or failure of a private company

	SUCCESS	FAILURE
Taxation	Can obtain tax rebates if they are involved in SCI projects.	Subject to double taxation e.g. shareholders pay secondary tax this can have a negative impact to a company that is already financially struggling.
Management	Managed at least by one competent highly skilled director.	Large management structures can result in decision-making taking time. .
Capital	Large amount of capital can be raised since there is no limit on the number of shareholders	It cannot grow into a very large business since it cannot invite the public to buy shares.
Division of Profits	Profits generated can be re-invested to expand business operations	Dividends are not always paid out, which may discourage new investors
Legislation	There is no longer a limit on the number of shareholders in a private company	Annual audit of financial statements (if required) is costly

PERSONAL LIABILITY

Characteristics (4)

- The company name must end with letters INC
- Directors have unlimited liability, and they are jointly liable for the debts of the business even if they are long out of office.
- The memorandum of Incorporation should state that it is a personal liability company.
- They must at least have one director on their board of directors.

Impact of a personal liability company

Advantages and/or disadvantages

NOTE: 1. The advantages of a personal liability company are the same as the private company.

2. The disadvantages are also the same as the private company **except** the directors of the personal liability company have unlimited liability.

Factors that contribute to the success and/or failure of a personal liability

	SUCCESS	FAILURE
Taxation	The company pays tax at a fixed rate, which can be lower than that of partnerships	Subject to double taxation, for example, when shareholders pay secondary tax it can harm a company that is already struggling financially.
Management	Shareholders can vote for and appoint the most capable directors to manage their company.	Directors' fees increase the company's expenses. which reduces net profit.
Capital	Capital can be increased by getting more shareholders.	A large amount of capital cannot be obtained as the capital contribution is only limited to private shareholders.
Division of Profits	Profits generated can be re-invested to expand business operations.	Dividends are not always paid out, which may discourage new investors.
Legislation	Directors sign performance contracts that will motivate them to perform professionally and ethically.	The drafting of directors' performance contracts may be time-consuming, expensive, and increase costs.

Differences between the private and a personal liability company

PRIVATE COMPANY	PERSONAL LIABLITY COMPANY
The name ends with (PTY) Ltd	The name ends with INC
The directors are not personally liable for the debts of the business.	The directors are personally liable for the debts of the business.

PUBLIC COMPANY

Characteristics (4)

- A minimum of one person is required to start a public company
- The company name ends with letters Ltd.
- Shareholders have a limited liability.
- Requires three or more directors and three or more shareholders

Impact (4)

- ✚ The business has its own legal identity
- ✚ Companies may buy and sell shares freely.
- ▪ Companies must disclose all financial information to their shareholders
- ▪ Large amount of funds is spent on financial audits.

Factors that contribute to the success and/or failure of a public company

	SUCCESS	FAILURE
Taxation	Can obtain government tenders and renew their licenses if they do not evade tax.	Subject to double taxation, for example, if shareholders have to pay the secondary tax this can harm a company that is already struggling financially
Management	Managed at least by one competent highly skilled director.	Large management structure can result in decision making taking time.
Capital	A public company's shares can be listed on the JSE which gives the company exposure to more potential investors.	Growth is limited if sufficient capital cannot be raised.

Division of Profits	Shareholders receive profits according to the type and number of their shares.	Dividends are not always paid out, which may discourage new investors
Legislation	The company and its owners (shareholders) are separate entities, which may encourage more people to join the company.	Annual audit of financial statements is costly

Difference between the private and public company

PRIVATE COMPANY	PUBLIC COMPANY
May not offer shares to the general public.	Trades its shares publicly on the Johannesburg Securities Exchange.
Minimum of one director	Minimum of three directors.
Name must end with Proprietary Limited/(Pty) Ltd.	Name must end with Limited/Ltd.

STATE-OWNED COMPANY

Characteristics (4)

- Requires three or more directors and one or more shareholders.
- It is owned by the government and operated for profit.
- SOC is listed as a public company.
- The name ends with letters SOC.

Impact (4)

- ✚ The profits may be used to finance other state departments
- ✚ Jobs are created at all skill levels
- ▪ It often results in poor management as the government is not always as efficient as the private sector.
- ▪ Losses must be met by the taxpayer.

Factors that contribute to the success and/or failure of a state-owned company

	SUCCESS	FAILURE
Taxation	Tax allowances are available to companies	Double taxation
Management	Managed by one or more directors, carefully selected.	Directors do not have a personal interest in the company.

Capital	It is easy to increase capital. Capital is contributed by the state and also private investors who buy shares.	Easy access to funding can lead to mismanagement and corruption
Division of Profits	Private shareholders receive dividends and the remaining profits are reinvested in the company to explain the company	Shareholders may sell their shares when dividends are low.
Legislation	Limited liability allows for greater risk taking, which may lead to growth of the business	The registration process is time consuming.

NON-PROFIT COMPANY

Characteristics (4)

- The main aim of NPCs is to provide services and not make a profit.
- They are funded by donations and foreign funding.
- The name of the company must end with letters/abbreviations on the non profit company.
- Qualifying NPSs are grantee tax-exempt status.

Impact (4)

+ The liability of the members is limited which may attract additional membership
+ Most of the income of non profit company is free from income taxes.
- They are not allowed to pay bonuses to members.
- Donations may not always be enough.

Factors that contribute to the success and/or failure of a non-profit

	SUCCESS	FAILURE
Taxation	May qualify for tax exemption if certain criteria are met.	Required to pay income tax if engaged in activities that are unrelated to their business purpose.
Management	An NPC may be well managed as it requires a minimum of three directors.	Directors may mismanage business funds as they may not have a direct interest in the NPC.
Capital	Unlimited number of founders may contribute more capital to the company.	NPC may struggle to raise enough capital and funds if they fail to convince donors and donations are misused

Division of Profits	The profits of the company are used to finance other needs of the company	May discourage potential investors from investing in the company as this is a non-profit company.
Legislation	The company and its owners (shareholders) are separate entities, which may encourage more people to join the company.	Formation procedures are time-consuming, complicated, and expensive, as many legal documents need to be prepared and submitted

CO-OPERATIVES

Characteristics (4)

- Minimum of five members is required to start a cooperative.
- Members contribute capital in the form of entrance fee.
- Register with the Registrar of Companies
- Legal entity and can own land and open bank accounts.

Impact (4)

- ✚ Access to resources and funding
- ✚ Decision making is by a group
- ▪ Difficult to grow a co-operative
- ▪ Decisions are often difficult to reach and time-consuming.

Factors that contribute to the success and/or failure of co-operatives

	SUCCESS	FAILURE
Taxation	Dividends declared by a company to a cooperative will be exempted from dividend ta	Co-operatives are taxed at the same rate as companies which may be high.
Management	All members have one vote each and decisions are made democratically	Decisions are often difficult to reach
Capital	Raises its capital by issuing shares to members	The funds of a co-operatives are limited and therefore it is difficult to grow.
Division of Profits	Each member has an equal share in the co-op.	The co-operatives is motivated by service rather than profit, which means less profit for members.
Legislation	Formation of co-operatives is easier than companies.	The process of formations is timeous and difficult.