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)

- This is the simplest and oldest form of ownership.
- The business is owned and managed by one person only.
- the owner has unlimited liability for the debts of the business
- There are no legal requirements regarding the name of the business.

Impact (4)

+ It is easy to start or end the business.
+ It requires little capital to start.
- The owner is responsible for providing all capital needed.
- The business is not a legal entity and has no continuity.

	SUCCESS	FAILURE
Taxation	The owner is only taxed on profits in a personal capacity.	If profits get too large, the owner may end up paying a bigger amount of tax in their personal capacity.
Management	The owners may be applying their own creativity when making important decisions.	Owners have to rely on their own experience and skills and can make incorrect decisions.
Capital	Capital will be carefully spent and managed because owners contribute all capital.	Profits may not be large enough for expansion.
Division of Profits	The owner receives all profits from the business which can lead to capital growth.	Profits may not cover all business debts which may hinder the expansion of the business legislation.
Legislation	It is easy to start.	Personal debts and business debts are one.

PARTNERSHIP

Characteristics (4)

- No legal formalities required to start, only a written partnership agreement is required.
- There are no legal requirements regarding the name of the business.
- Partners combine capital and may also borrow capital from financial institutions.
- Profit is shared according to the partnership agreement

Impact (4)

✚ Partnerships are not compelled by law to do audits.

✚ Partners can put their knowledge and skills together to collectively make the best decisions.

▪ There is a lack of continuity. If one partner dies, retires, or leaves, a new partnership must be formed.

▪ Partners might not all contribute money, and assets equally.

	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	Partners can be creative and have access to the expertise of other partners when difficult decisions have to be made.	Decision-making can be time-consuming as all partners have to agree.
Capital	More capital can be obtained because more than one partner contributes to capital.	Unequal inputs as some partners put in expertise instead of cash.
Division of Profits	Profits are divided according to a written partnership agreement which helps to limit misunderstanding/ disagreement	The amount of work done may not be equal to the amount of profit that each partner receives which could lead to dissatisfaction.
Legislation	Easy and cheap to establish, as partners must draw up a partnership agreement.	If one partner dies or retires, the remaining partners need to draw up a new agreement.

PRIVATE COMPANIES

Characteristics (4)

- The company name ends with the letters (Pty)Ltd
- A private company is not allowed to sell shares to the public.
- The company raises capital by issuing shares to its shareholders.
- Profits are shared in the form of dividends in proportion to the shares held.

Impact (4)

- ✚ Companies pay tax on a fixed tax rate
- ✚ A company has continuity of existence
- ▪ Companies must prepare annual financial statements
- ▪ Must adhere to the tax requirement of the government

	SUCCESS	FAILURE
Taxation	The company pays tax at a fixed rate on its profit.	Companies are subject to double taxation, for example, shareholders pay the secondary tax which could discourage investors from buying shares in the company.
Management	Managed by at least one competent highly skilled director.	Large management structures can result in decision-making taking time.
Capital	More capital can be raised by issuing shares to shareholders	More capital can be raised by issuing shares to shareholders
Division of Profits	Shareholders receive profits according to the number of their shares.	Dividends are not always paid out, which may discourage new investors
Legislation	Limited liability allows for greater risk-taking, which may lead to the growth of the business.	Annual audit of financial statements (if required) is costly

PERSONAL LIABILITY

Characteristics (4)

- The company name must end with the letters INC.
- Past and present directors may be held responsible for the debts of the business as liability for debt is unlimited.
- The Memorandum of Incorporation should state that it is a personal liability company.
- The company must have at least have one director on its board of directors.

	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.

PUBLIC COMPANY

Characteristics (4)

- A minimum of one person is required to start a public company
- The company name ends with the letters/abbreviation Ltd.
- The shareholders of a company have limited liability.
- The company has a legal personality and unlimited continuity

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
- ▪ Audits are compulsory and a big amount is spent on financial audits.

	SUCCESS	FAILURE
Taxation	The company pays tax at a fixed rate on its profit.	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 by a board of competent highly skilled directors, which results in better decision-making	Directors' fees increase the company's expenses and reduce net profit.
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.	Listed companies may trade its shares publicly on the Johannesburg Security Exchange.
Minimum of one director	Minimum of three directors.
The name must end with Proprietary Limited/(Pty) Ltd.	The name must end with Limited/Ltd.

STATE-OWNED COMPANY

Characteristics (4)

- A state-owned company must have three or more directors and one or more shareholders.
- It is owned by the government and operated for profit.
- State-owned companies are listed as public companies.
- The name ends with the letters/abbreviation SOC.

Impact (4)

- ✚ The profits may be used to finance other state departments
- ✚ SOCs can create jobs for 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.

	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.
- If they qualify, NPCs can receive grants.
- Most of the income of non profit company is free from income taxes.
- They are not allowed to pay bonuses.
- Donations received from the public may not always be enough.

	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	Donors in non-profit companies may receive tax rebates which may encourage further contributions.	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)

- A minimum of five members is required to start a co-operative.
- The objective of a co-operative is to create mutual benefits for the members.
- It is a legal entity and can own land and open bank accounts.
- The decisions are taken democratically, in other words, the member's vote wins.

Impact (4)

- ✚ Formation of co-operatives is easier than companies.
- ✚ A co-operative can appoint its management.
- ▪ Financial statements must be audited.
- ▪ Decisions are often difficult to reach and time-consuming.

	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.