INTRODUCTION TO BUSINESS (ACC 103)

Topic 2- Forms of Business Ownership and Management

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Introduction

- ❖ In starting a business enterprise, one of the key decisions is making a choice about the form of ownership;
- ❖ Business ownership can take different legal forms, each with its varied privileges, responsibilities, pros and cons that need to be considered before making such decisions;
- ❖ Other germane issues for consideration when choosing business type are:
  - ➢ *The extent to which you want to be personally liable for both financial and legal risks;*
  - ➢ *The person/group that will hold the controlling interest;*
  - ➢ *The type of financial structure that the business will have;*
  - ➢ *Transferability of ownership;*
  - ➢ *Ability and capabili The ease with which the organisation and dissolution are allowed to occur;ty of the entrepreneur;*
  - ➢ *The business's tax position;*
  - ➢ *Government laws and regulations;*
  - ➢ *Continuity of ownership to achieve being a going concern.*

Forms of businesses

- **There are three legal structures that can be chosen from:**
  I. **Sole proprietorship (SP);**
  II. **Partnership;**
  III. **Corporations with the following specific options:**
     - *Partnerships;*
     - *Corporation.*
  IV. **Others are cooperative societies and the Not-For-Profit organisations**

- Generally, sole proprietorship is the most common business type in nations of the world, including the **USA and Europe**; this is particularly connected to the fact that SMEs are the dominant business types the world over;

- The point is that there is no single perfect form of business organisation;
  - Your choice will depend on *your short and long term needs, tax policies with a country, personal preferences, your capabilities and available resources*;

- The legal form of ownership should not be confused with business size.

I. Sole proprietorship

- This refers to a business that is owned, operated and managed by a single individual with the sole aim of making profit;
- The owner:
  - Manages, take decisions, take responsibilities and has final authority;
- It is the oldest and the easiest business type to own a start-up;
- Sole Proprietorship (SP) is also known as an unincorporated business form since no permission is required from government before setting it up;
- Although registration is not compelled by law, it may, however, still be registered as a business with the Corporate Affairs Commission;
- Apart from tax, the business has no other legal obligation to government;
- Examples of SP in Nigeria are:
  - Retail outlets like supermarkets, schools, poultry, training institutes, laboratory services, art and craft works and computer engineering etc.

Characteristics of Sole Proprietorship

- ❖The Business is owned and managed by a single individual who provides the capital to establish and run the business;
- ❖ It is self-managed;
- ❖ It is rather small in size in comparison with the other business types;
- ❖ It is the most common type of business ownership in Africa, West Africa sub-region and Nigeria;
- ❖The business is for-profit maximisation by nature;
- ❖The owner has unlimited liability as he/she is personally responsible for meeting all financial obligations of the firm including debts.

Advantages of Sole Proprietorship

- ❖ The owner can be reached easily on matters concerning the business;
- ❖ The owner enjoys the benefits, freedom and flexibility to manage the business personally;
- ❖ It is possible to reduce wastage since the business is self-manage by the owner;
- ❖ The owner enjoys business independence;
- ❖ Owner's personal commitment;
- ❖ No need for formality to organise and dissolve the business;
- ❖ Legal requirements for starting the business is insignificant;

Disadvantages of Sole Proprietorship

- ❖ Limited financial resources due to fundraising difficulty;
- ❖ The business is prone to failure due to owner's inexperience and incompetence;
- ❖ Continuity challenges as the business life span is linked to the ability and/or life span of the owner;
- ❖ Limited opportunity for expansion;
- ❖ Unlimited liability (the potential for a business owner to lose more than the owner invested in a business;
- ❖ Lack of opportunities for employees in terms of job enlargement, ambition and career development;
- ❖ The owner usually put in long hours and may sometimes sacrifice own gains for the business;

II. Partnership

- ❖ This is a voluntary association between two or more people who come together to co-own a business for profit by pulling their resources together;
- ❖ Partnership is one of the two options opened to people who want to go into business together, the other form is a corporation;
- ❖ Though not recommended, it is possible to go into partnership without a formally written document;
- ❖ But, in the absence of a written agreement, the business operates in line with the state's regulation governing partnership business;
- ❖ In Nigeria, a partnership is registered under Companies and Allied Matters Act of 1990 and has to comply with the relevant provisions;
- ❖ Partnership is limited to 2-10 people for banking and consultancy and 2-20 for other business types.

Partnership

- ❖ Unlike the sole proprietorship, partners are expected to bring complementary skills to the business and jointly source for resources to sustain the business;
- ❖ Partnership is of two broad types:

  - ➢ **General/ordinary partnership:**
    - This is the more common type and describes a business structure in which all the owners have equal share of both the management and risk of the business;
    - It means that each active partner may take part in managing the business and equally liable for the potential debts;

  - ➢ **Limited partnership:**
    - ▪ This describes the sort of partnership in which at least one of the partners will have limited liability;
    - ▪ It therefore means that at least one of the partners is responsible for all debts of the partnership and therefore has greater powers, rights and responsibilities than the limited partners;
    - ▪ The limited partner (s) do not take part in the management of the business, and their liability is also limited to the amount of capital they have invested.

Sub-division of partnership types

i. **General/active partner**
- This partner contributes money to the business and takes active part in operating and managing the business;
- Has unlimited liability and may act as business manager, supervisor or director in the firm;
- The active partner is usually paid a salary if the deed of the business provides for such;
- But, where provision for payment is not made, then no payment is made as all active partners are presumed to take active part.

ii. **Limited/special partner**
- This indicates that the partner has limited liability and that his/her responsibilities are limited to the investment alone;
- The partner takes no active part in the management and running of the business.

iii. **Sleeping/dormant partner**
- The partner does not take active part in managing the business and his/her partnership is unknown to the public;
- The partner merely contributes capital to the business.

iv. **Nominal/passive partner**
- This partner does not contribute any money to the business but only consents to his/her names being used as one of the partners without any real interest in the business.

v. **Secret partner**
- This is a partner that participates adequately in the running of the day-to-day business of the firm but his/her membership is hidden from the public;

vi. **Silent partner**
- This partner is known to the public as an important partner but takes little active part in managing and running the business.

Advantages of partnership

- Availability and access to financial resources;
- Privacy – Annual statements of account are not open to public scrutiny;
- Easy to form the company;
- Control in the hands of the owners;
- Greater potential for continuity compared to sole proprietorship;
- Shared managerial talent and pooled knowledge;
- Sharing of gains, risks and losses;
- Division of labour;

Disadvantages of partnership

- Unlimited liability;
- Delay in decision making;
- Challenges to continuity if anything happens to one of the key partners;
- Slow expansion potential;
- Difficulty in ownership transfer;
- Potentials for friction and disagreement;
- Limited degree of freedom for partners.

III. The Corporation/Limited Liability Company/Joint Stock Company

- ❖ This is the most complicated business structure;
- ❖ It is an autonomous entity consisting of an association of individuals or corporations that are created under the authority of existing law;
- ❖ In this form, the powers and liabilities are separated from the owners;
- ❖ It has the ability to sue and be sued, own properties and engage in business transactions;
- ❖ The corporation must act in accordance with the charter and the state laws in which the business is set up;
- ❖ Each of the owners' liability is limited to the tune of their individual investment.

Characteristics of a corporation

- It is an entity that is totally separated from its owners;
- Owners liability is limited to their investment;
- The owners may have little to do with managing the business;
- The corporation can exist perpetually because it is created by law;
- Because it is a separate legal entity, the corporation is taxed separately from its owners.

Advantages of corporations

- The limited liability available to owners;
- Ability to raise large amount of financial resources;
- Distribution of wealth;
- Advantages of scale of the business;
- Specialised managerial capabilities, skills and knowledge of several people;
- Legal entity separating it from owners;
- Continuity of operations and company.

Disadvantages of corporations

- The challenges of complying with the requirements of the state's corporate code;
- The challenges of double taxation;
- Loss of control every time you sell part of your stock;
- Lack of secrecy that is available under smaller business types;
- Difficulty in terminating the business once established;
- Delayed decision making;
- Reduced personal interest due to separation of ownership;

IV. The cooperative societies

- Corporative societies came to existence during the industrial revolution in the 19th century with the key aim of alleviating the economic distress suffered by members;
- The first cooperative society in contemporary society was established in Britain in 1844 with the opening of a cooperative store in Lancashire near Manchester;
- However, modern day associations consist of a group of people who pool their resources to make profit mainly for the benefit of members;
- Members participate freely in business activities and are entitled to interest on investment and patronage dividends;
- The share of the profit is normally based on the level of each member's participation.

The basic features of cooperative societies

- Open membership;
- Democratic control (one person, one vote);
- Limited interest on capital invested and money borrowed;
- Membership is not transferrable;
- There must be religious and political neutrality;
- Cooperative not required by law to publish its accounts;
- Free entrance and free exit.

Types of cooperative societies

- Consumer cooperative societies;
- Cooperative credit societies;
- Farmers’ multi-purpose cooperative societies;
- Produce/producer marketing cooperative societies;
- Housing and building societies.

Advantages of cooperative societies

- ❖ Fundraising is fairly easy;
- ❖ Profit of the group is not subject to tax;
- ❖ Members have equal rights;
- ❖ Loans are available to members at cheaper rate;
- ❖ Members are able to enjoy benefits that are not available to the general public;
- ❖ They help member to cultivate saving habit;
- ❖ Members are allowed to withdraw their capital at short notice.

Disadvantages of cooperative societies

- ❖ Low capital base;
- ❖ Qualifications and experience of members of the committee are not guaranteed;
- ❖ Mismanagement, particularly of funds;
- ❖ Members base the success of the society on the amount of dividends shared, and where this is unsatisfactory, eye brows will be raised;
- ❖ Because members can withdraw their capital any time, there is always some form of instability;
- ❖ Coop societies sometimes spend their money in funding political parties.

The Not-For-Profit organisations

- ❖ This form is a tax-exempt organisation formed by religious, educational, charitable, literary groups etc.;
- ❖ They exist for purposes other than profit making;
- ❖ NFP depend heavily on grants from private and public donations to meet the day-to-day expenses;
- ❖ When individuals contribute to NFP organisations, they are entitled to deduct the contribution from their own taxes;
- ❖ In case a NFP organisation winds down, it assets must be donated to another NFP.