Chapter 19

Types of Business Organisation

Contents & Key Study Questions

Case Study: Premium Suds

Evan Sullivan did not like the idea of working for someone else and wanted to set up his own business. He noticed how much time people seemed to spend queuing up at regular car washes and saw an opportunity to set up a mobile car washing service. 'I would bring the car wash to the customer and could also valet their car for them.'

Evan chose Premium Suds as his brand name, bought a steam cleaner, high-powered car vacuum cleaner and lots of soap and car wax. He advertised online and through door-to-door flyers. Over the course of two years, he built up a very profitable small business and now employs two part-time assistants.

'Sure, the work is hard,' admits Evan 'but I like it. Plus, I am my own boss and can get to choose my own hours. I'm very happy that I made the decision to start my own business.'

When he set up in business, Evan was a **sole trader**. This means that he is the sole owner of the business. He makes all the decisions and gets to keep all the profits.

Now that the business has become well established, he has thought about bringing in a

business partner to help grow the business further. He has also considered converting it into a **limited company** to reduce his business risk.

This chapter looks at the different types of legal structures a business can have and the implications of each. It also looks at how the business structures can change over time to suit different circumstances.

A. Structures used by new businesses

When an entrepreneur like Evan Sullivan is starting up in business, he or she must choose from four main types of different legal structures: **sole trader**, **partnership**, **limited company** or **co-operative**. A fifth type, known as a State enterprise, is sometimes used by the government when setting up a business. These different legal structures of a business can be compared using the following headings:

- **Formation** – How are they set up and how can they be dissolved?
- **Finance** – What costs are involved? How can the structure be used to raise finance for growth? What happens to profits?
- **Risk** – What is the risk for the owners if the business goes bust?
- **Control** – Who owns them and how much control have they over the business?

The five basic legal structures for new businesses:
- Sole trader
- Partnership
- Limited company
- Co-operative
- State-owned

1. What is a sole trader?

Evan Sullivan set up Premium Suds as a sole trader. It is the simplest form of legal structure. **Sole traders** *own and manage their own business*. They are the **most common** type of legal business structure in Ireland and are frequently found among businesses such as small shopkeepers, farmers, family businesses, musicians and tradespeople such as plumbers and electricians.

Feature	Explanation
Formation	• When setting up, sole traders must fill in a form TR1 with the Revenue Commissioners for tax collection purposes. • If using a special business name, such as 'Premium Suds', then the **business name** needs to be **registered** with the Companies Registration Office. This allows the real identity of the owner to be established if there is a legal dispute. • For some types of business, such as a pub, you may also need to get a licence from the courts.
Finance	• Sole traders can raise finance from their own **savings**, business grants or loans from banks or other sources. • Financial affairs of the business are private. Business accounts are not submitted to the Companies Registration Office. • Sole traders get to **keep all the profits** of the business.
Risk	• Sole traders have **unlimited liability**. Unlimited liability means the owner bears full personal responsibility for all the debts and actions of the business. If the business goes bankrupt and owes money, then the sole trader is personally liable for all the debts of the business.
Control	• Sole traders have **total control** over business decision-making. Even if they have employees, they are the boss.

Evaluation of setting up as a sole trader

Sole traders own and control all aspects of their business and have unlimited liability.

Advantages

- **Formation.** Very quick and easy to form. Sole traders have the least amount of paperwork to deal with.
- **Finance: Privacy** is protected as the financial accounts of the business only have to be revealed to the tax authorities. The sole trader keeps all the profits after taxes are paid.
- **Control.** The business is owned and controlled by a single person. Speedy decision-making means they can respond quickly to competitors and the needs of customers.

Disadvantages

- **Finance:** Can only raise equity finance by investing personal savings. Loans are often more expensive for small businesses.
- **Risk:** Sole traders have unlimited liability, so they *bear full personal responsibility for all the debts and actions of the business.*
- **Control:** No help or advice from a business partner with important decision-making.

Case Study: Ed Sheeran – from sole trader to limited company

When Ed Sheeran was starting out in music he was simply a **sole trader** busking on the street. He considered setting up his own band and forming a **partnership** but decided against doing that. He liked his independence and had confidence in his ability to make it big in the music industry on his own. Working independently, he released his debut album which became a massive hit, selling millions internationally. As his career took off and the money began to flow in, he set up a **limited company**, Ed Sheeran Limited, to reduce his financial risk. There is only one shareholder in the company – Ed Sheeran himself. He recorded and released more albums and his success continued. He is now one of the biggest selling singer/songwriters in the world and has sold over 150 million albums.

Fieldwork

1. Identify one advantage for Ed Sheeran of being a sole trader.
2. Look up **Ed Sheeran Limited** on the Internet and identify (a) how many employees it has and (b) its most recent revenue turnover.
3. Identify three sole traders operating in your local area. In what sectors of the economy is each operating?
4. What do you consider to be the most important **advantage** and **disadvantage** of operating as a sole trader?

2. What is a partnership?

A **partnership** *is two or more people (but not more than twenty) who are in business together in order to make a profit.* In Ireland, partnerships are commonly found among businesses such as accountants, solicitors, architects and rock bands.

Feature	Explanation
Formation	• Two or more people required. • When setting up, business partnerships must be registered with the Companies Registration Office • They must also register with the Revenue Commissioners for tax collection purposes. • Partnerships are often formed through verbal agreements. However, it is advisable to have a written **partnership agreement**, known as a deed of partnership. A deed of partnership is a written agreement containing the rules and conditions for running a business as a partnership. It is used to avoid future disagreements.
Finance	• Between 2 and 20 partners can invest savings in the business. • A partnership can also borrow finance from a bank and apply for grants. • Financial affairs of the business are **private**. • **Partners share all the profits** of the business.
Risk	• Partners in business have **unlimited liability** for all the debts and actions of the business. This means they could potentially lose personal assets to pay off any business debts.
Control	• **Decision-making and control are shared** by the partners.

Evaluation of setting up as a partnership

Partnerships involve the sharing of ownership and control with others. Partnerships have unlimited liability.

Advantages

- **Formation:** Partnerships are easy to form. The deed of partnership agreement is optional.
- **Finance:** New partners (up to 20) can bring in extra finance or expertise needed to expand the business. Financial risk is shared. Like sole traders, the financial affairs of the business are confidential. Two or more people working together can often achieve more than working alone. This can significantly boost profitability and reduce the business risk.
- **Control:** Work responsibilities and stress can be shared. Partners can bring different talents, skills and expertise into a business which should mean better decision-making.

Disadvantages

- **Formation:** The partnership is not a separate legal entity from the partners. The business therefore has no continuity of existence. If a partner dies or leaves, the partnership ends and a new partnership must be agreed.
- **Finance:** It can be more difficult for partnerships to borrow finance than for a company. Profits must be shared between the partners. The more partners, the smaller the share for each.
- **Risk:** Each partner has **unlimited liability**.
- **Control:** Partners may have disagreements, making the business difficult to run.

Case Study: Paws Pet Clinic

Paula Delaney and James Murray both graduated from college as vets. They are both energetic and hard-working individuals and decided to set up their own veterinary practice called 'Paws Pet Clinic'.

After locating suitable premises on the edge of a large town, they used a combination of equity and loan finance to install pet consulting rooms, an X-ray facility, an operating theatre, recovery rooms and kennels. Their friendly, professional and caring approach to treating pets has led to the business growing quickly.

As a business, Paula and James are currently operating as a partnership although they have not agreed anything in writing. For now, they have agreed to split the income from the business 50:50. However, Paula is concerned that disagreements may arise in the future. 'What will happen if one of us wants to take longer holidays?' she asks. 'Should we still be sharing all the profits equally?'

Recall and Review

1. Identify the problems that you think might occur in a partnership but not as a sole trader.
2. Draw up a list of points that you think the vets should put into their partnership agreement.
3. What do you consider to be the most important advantage and disadvantage for the pet clinic of operating as a partnership?

3. What is a company?

Companies *are businesses owned by investors who are called* ***shareholders.*** *They are registered with the Companies Registration Office and have* ***separate legal identities from the owners.*** This means that companies can enter into contracts and can sue and be sued in their own right, as if they were real people.

Article: The Companies Registration Office (CRO)

All companies and co-operatives set up in Ireland must register with the Companies Registration Office (CRO). The **CRO** *is the state agency responsible for ensuring that businesses operating under company and co-operative law comply fully with their legal obligations.*

If a firm is found to be in breach of the rules for running a company or co-operative, then it may be 'struck off' the CRO's list. This means that the owners of the business lose the benefit of limited liability protection. The CRO is also responsible for the registration of business names for all types of businesses, including sole traders, partnerships, companies and co-operatives.

Under the **Companies Act 2014** there are three common types of company in Ireland:

- **A Private Limited Company (LTD)** *is a business owned by investors called **shareholders**.* The money raised from the private sale of shares to these investors is used to finance the business. Any profits made are divided among shareholders in the form of **dividends**. If there are losses, shareholders have the protection of limited liability.

  Limited liability protection *means that the shareholders are not personally liable for any of the business's debts. They only lose the value of their investment in the business if the business goes bankrupt*. The words 'Limited' or 'Teoranta' must appear at the end of the company name. Private limited companies are free to engage in any type of commercial activity. These are by far the most common type of company in Ireland.
- **A Public Limited Company (PLC)** *is similar to a private limited company but with the additional benefit that its shares can be freely bought and sold by the public on the stock market. For example, Ryanair PLC, Bank of Ireland PLC, Kingspan PLC.* PLCs normally start as Private Limited Companies but choose to change into PLCs in order to raise finance by selling shares on the stock market.
- **A Company Limited by Guarantee (CLG)** *is a specific form of organisation that has members instead of shareholders*. The members have limited liability and only guarantee to pay a small nominal sum (e.g. €1) towards any debts that may be owed if the business closes down. This structure is used by charitable and not-for profit organisations such as sports clubs.

Two other less common types of companies are:

- **Unlimited Company (UC)** *is similar to a private limited company, but financial accounts do not have to be made available for public inspection through the Companies Registration Office. The downside is that shareholders do not have the protection of limited liability.* As a result, Unlimited Companies are relatively rare.

Example: Dunnes Stores is an unlimited company. The owners, the Dunne family, are the shareholders and have unlimited liability but they do not have to submit accounts to the Companies Registration Office (CRO) so they can keep their finances private.

- **A Designated Activity Company (DAC)** *is similar to a private limited company but is only set up for a very specific purpose.* It is illegal for the company to engage in any activities outside of its stated purpose.

Example: Irish airline CityJet is a DAC company set up specifically to fly aircraft. It would be illegal for it to open a supermarket or build a housing estate.

Feature	Explanation
Formation	• Companies can be formed by between 1 and 149 shareholders. • Companies must be registered with the **Companies Registration Office**. They must have a **Company Constitution** setting out the rules for running the company, such as the way meetings are to be conducted and the procedure for electing and replacing directors. • After registration with the Companies Registration Office (CRO) and payment of a registration fee a **Certificate of Incorporation is issued and the business can start trading**.
Finance	• There is a **lack of financial privacy** for <u>Limited</u> Companies as their accounts and ownership details must be lodged with the Companies Registration Office every year and are available for public inspection. This requirement does not apply to the far less common Unlimited Companies. • Profits are shared among shareholders in the form of **dividends** according to how many shares are owned.
Risk	• Shareholders in Limited Companies have the **protection of limited liability**. This means they can only lose the value of their investment if the business goes bankrupt. This protection does not apply to shareholders in Unlimited Companies.
Control	• Companies are owned by shareholders on the basis of **one share = one vote**. • **Shareholders elect the board of directors** to run the company. • Whoever controls more than 50% of the shares can control the company.

Running a limited company

Shareholders are the legal owners of a company limited by shares. Every company with two or more shareholders is required to hold an Annual General Meeting organised by the board of directors.

Annual General Meetings (AGMs) *of company shareholders hear reports on the performance of the business from the outgoing directors, elect directors to the board for the coming year and approve a dividend to be paid to shareholders.* AGMs must be held once a year. Sometimes a special **Extraordinary General Meeting (EGM)** of shareholders may be called to deal with a very important matter that cannot wait until the AGM (e.g. a takeover bid).

The **Board of Directors** *are the most senior managers of the company. They are elected by shareholders to oversee the running of the company on their behalf.* Directors are elected or removed from their position by a vote of shareholders at an AGM or EGM. Their role is to:

- **Set** the overall direction and strategy for the firm.
- **Appoint a Chief Executive Officer (CEO)** *or* **Managing Director (MD)** *who will be responsible for all aspects of the company's activities and who will achieve the targets set by the board of directors.* The CEO or MD is answerable to the board of directors.
- **Make** or approve important decisions in consultation with the CEO or managing director.
- **Report** to the shareholders at the AGM on the performance of the company.
- **Decide** on the size of the annual dividend to be paid to shareholders.

The **Company Chairperson** *is a director elected by the board of directors to chair the company's board meetings, AGMs and EGMs.* He/she also speaks on behalf of the board of directors.

Companies are owned by shareholders who elect a board of directors to oversee the running of the business on their behalf.

The board of directors appoints a managing director or CEO to be the top manager in the business and to achieve the goals set by the board.

The **Company Secretary** *ensures that the company meets all the legal requirements as set out under the Companies Acts.* It is a very important legal role in companies and includes:

- Maintaining an up-to-date register of names and addresses of shareholders.
- Organising AGMs and EGMs.
- Keeping minutes of board meetings, AGMs and EGMs.
- Making annual returns to the Companies Registration Office (CRO).
- Informing directors of significant issues affecting the company.

Evaluation of setting up as a company limited by shares

Advantages

- **Formation:** Companies are legally independent of their owners. They have **continuity of existence** which means they can continue to exist even if a shareholder leaves or dies.
- **Finance:** Companies can raise finance for start-up and expansion through **selling shares**. Companies can motivate employees by giving them a shareholding in the business. Being 'incorporated' as a limited company can also improve business image and creditworthiness with suppliers and banks. If there is just one shareholder, they can keep all the profits and not bother with AGMs.
- **Risk:** The owners (shareholders) have the protection of **limited liability**.
- **Control:** The company is **owned by its shareholders**. It is cheap and easy to transfer the legal ownership of shares from one person to another.

Disadvantages

- **Formation:** Companies are more **complex** to set up and run than sole traders or partnerships.
- **Finance:** There is a **lack of privacy** as annual accounts and reports must be submitted to the Companies Registration Office. This information is available to the public, including rivals. Companies also have to deal with extra administrative paperwork for the CRO which increases costs. Profits must be shared among all the shareholders, depending on the number of shares held.

Case Study: Premium Suds

Now that the business has become well established, Evan Sullivan is thinking about how to expand his Premium Suds mobile car wash and valet business without taking on too much risk. He has thought about bringing in a **business partner** but is concerned about losing control of the business. He is now considering converting Premium Suds into a **limited company but needs advice**.

Recall and Review

1. What do you consider to be the most important advantage for Evan of converting his business into a limited company?
2. What do you consider to be the most important disadvantage for Evan of converting his business into a limited company?
3. What advice would you give Evan?

4. What is a co-operative?

Co-operatives *are businesses that are democratically owned and controlled by their members who may be the firm's employees, suppliers or customers.* Legally, co-operatives must have at least seven members. However, unlike a limited company, each member can only own one share. This is intended to promote fairness and co-operation among the members. There are several types of co-ops:

- **Consumer co-ops** are businesses owned by their customers. Credit unions are a type of consumer co-op owned by the members who are also their savers. Credit unions are a very common form of co-operative business in Ireland.
- **Worker co-ops** are owned and run by the employees in the business.
- **Producer co-ops** are owned by producers, such as farmers or fishermen.

Feature	Explanation
Formation	• Must register with the Registry of Friendly Societies through the Companies Registration Office. • Must have at least 7 members.
Finance	• Raise finance from members. Can also borrow from banks and apply for grants. • Profits are shared among the members according to the rules of the co-operative.
Risk	• Co-op members are protected by limited liability. The most they can lose is the amount they invest in the co-op.
Control	• Each member has one vote regardless of the number of shares they own. This makes co-ops a very democratic structure.

Evaluation of setting up as a co-operative

Advantages

- **Control:** Every member has a say in how the business is run, regardless of how many shares they own.
- **Finance: Finance can be raised from the members.** Profits are shared among members.
- **Risk:** Members have the protection of limited liability.

Disadvantages

- **Formation:** Needs at least 7 members and to be registered with the Registry of Friendly Societies.
- **Finance:** Can sometimes have difficulty raising large amounts of finance from members for expansion.

Case Study: Life Credit Union Newbridge

Life Credit Union in Newbridge, County Kildare is a type of consumer co-operative. It is owned by its customers who are also its shareholders. Everyone who opens a savings account with the credit union becomes a member with a share ownership in the co-operative.

Like other credit unions, the Life Credit Union offers a range of financial services that compete with the commercial banks including savings and current accounts, online banking and insurance products. However, unlike the commercial banks, when the credit union makes a surplus (profit), this is paid back to the members as a dividend. As a result of this customer-centred structure, credit unions are very common and successful co-operative businesses in Ireland.

Signpost:
See **Chapter 16 Getting Started** for comparison of different forms of legal structure

Fieldwork

1. What type of co-operative is a credit union?
2. Find out the name and address of your local credit union.
3. Make a list of five services it offers its members.

5. What is a state-owned company?

State-owned companies *are owned, financed and controlled by the State on behalf of the taxpayer. They are also referred to as* ***semi-state*** *or* ***state-sponsored companies***. Well-known examples include Coillte (forestry), RTÉ (media) and CIÉ (transport).

State-owned companies are owned and controlled by the State. They have limited liability.

Feature	Explanation
Formation	• State companies can be set up using specially written legislation (laws) and are known as statutory companies. • Alternatively, a state-owned company can also be registered with the Companies Registration Office as for regular limited companies but with the State as the shareholder.
Finance	• The government provides the start-up finance for the business and may also agree to subsidise any losses that are incurred. • The government may guarantee the repayment of any loans that the state company had to take out. • Profits generated may be reinvested in a state enterprise or paid out in dividends to the government.
Risk	• Any losses suffered by a state-owned company means that it is really the taxpayers who lose money.
Control	• As the shareholder, the government appoints the board of directors to oversee the management of a state company. • Each state-owned company is the responsibility of a particular government department. For example, Bus Éireann reports to the Department of Transport.

Coillte is the state-owned forestry company.

B. Structures used to expand a business

Businesses that were originally set up as sole traders, partnerships, co-operatives, private limited companies or state-owned companies may choose additional structures to expand their businesses. These can include:

- An existing co-op, private limited company or state-owned company **becoming a public limited company.**
- Existing businesses **entering into a strategic alliance** together.
- An existing business deciding to **expand by franchising** the business idea.
- Indigenous Irish-owned firms expanding internationally, some **becoming transnational** firms.

6. What is a public limited company?

Case Study: Glanbia PLC

Glanbia PLC is an Irish business that produces specialist nutrition products, such as protein powders, using brand names like SlimFast and Optimum Nutrition. The business started out as a small producer co-operative owned by farmers selling milk and cheese products. The co-op was very successful in Ireland and decided to expand internationally using takeovers that would allow it to develop economies of scale. However, it knew that expansion by acquisition would be expensive and require raising large amounts of finance. The farmers who owned the co-op did not have the money required. The business also did not want to take on large loans. Instead, the co-op decided to set up a separate PLC to raise the finance needed by selling shares to investors. Glanbia's use of a PLC structure to raise finance worked and the money raised was used to expand internationally by buying companies in the UK, Germany, US, Canada and China.

www.glanbia.com

A public limited company (PLC) like Glanbia has to have at least seven shareholders. There is no maximum number of shareholders. The big difference between it and a private limited company is that shares in a PLC can be freely bought and sold on the stock market. The shares of most Irish PLCs are traded on the Dublin Stock Exchange. However, some Irish companies have also secured stock market listing on the London or New York Stock Exchanges.

Evaluation of operating as a public limited company

Advantages

- **Formation:** A PLC must start off as a private limited company before applying to a stock exchange for a listing – also known as 'going public' or 'floating on the stock market'.
- **Finance:** PLCs can access **large sources of finance** by selling more shares on the stock market. **Talented staff** can be rewarded with **options to buy shares** in the business at a discount. The prestige of being a PLC can significantly improve a firm's business image and **creditworthiness** with suppliers and banks. Overall, it can help a business to expand and become more profitable.
- **Risk:** The owners (shareholders) have the protection of **limited liability**.
- **Control:** It is cheap and easy for shareholders to transfer the legal ownership of shares from one person to another.

Disadvantages

- **Formation:** The requirements for registering as a PLC are time consuming and **complex**. Stock market listings are only available to well-established companies.
- **Finance:** Detailed information must be made public about the PLC's financial and other activities. This **reduces confidentiality** for the business. PLCs also have to comply with very **detailed regulations** that impose considerable administrative costs. Many shareholders in PLCs are speculators with a very short-term view of the business who expect regular and high dividends to be paid. This can put pressure on senior managers to constantly generate profits or be fired.
- **Control:** By having its shares openly on sale on the stock exchange, a PLC can become an easy target for a takeover. Once an investor acquires more than 50% of the shares, they can control the board of directors and the direction of the business.

Public limited companies are owned by shareholders who can buy and sell their shares freely on the stock market. PLC shareholders have limited liability.

Case Study: Shareholder rebellions

Companies are owned by shareholders who elect the board of directors to manage the business on their behalf. Sometimes, the views of management and shareholders can be very different.

For instance, the board of directors of Volvo PLC announced that it was planning to merge with Renault PLC to form a new giant car company. Before the deal could be finalised, it had to get the agreement of a majority (50%+) of shareholders in both companies. Volvo's board of directors was confident that the company's shareholders would vote in favour of the deal.

However, when the Volvo board of directors called an **EGM** to get shareholder approval the directors got a shock. Despite a huge amount of planning by Volvo's managers, the company's shareholders were not impressed with the proposal of merging with Renault which they thought would be more like a **takeover** than a genuine **merger**. The shareholders voted overwhelmingly against the deal, which could not now go ahead.

Similarly, the board of directors of Fyffes and Chiquita agreed to merge their companies to form the largest banana company in the world. Before the deal could go ahead, a majority of shareholders in both companies had to approve it. However, when Chiquita shareholders voted against the merger at their company AGM, the billion-dollar deal collapsed.

Recall and Review

1. Who are the owners of a PLC?
2. Identify one major difference between a private limited company (LTD) and a public limited company (PLC).

7. What are strategic alliances?

Strategic alliances (joint ventures) *are agreements between businesses to co-operate in the establishment of a project or business together.* As a form of business ownership, the firms involved share ownership of the project, as well as pooling their skills and resources.

Example: Toyota and Mazda were rivals in the very competitive car market. However, a changing business environment made them change their minds and they decided to form a strategic partnership to share costs and expertise in researching and developing electric and self-drive vehicles. They also agreed to build and share new car factories. Toyota has also co-operated with BMW on the development of electric vehicles.

Evaluation of operating as a strategic alliance

Advantages

- **Formation:** They are formed by a **contract** negotiated by two separate businesses.
- **Finance:** Both firms can invest funds and share the costs of the venture. Sharing costs can reduce waste and increase profitability.
- **Risk:** By co-operating in sharing expertise and costs, both businesses are likely to reduce the level of risk involved.
- **Control:** Shared ownership and control can mean pooling **expertise**. Expansion can be faster when two or more firms co-operate in a joint venture.

Disadvantages

- **Formation:** Negotiating the contract between two or more separate businesses can be slow and time-consuming. Withdrawal from the contract at a later date by one party will require the consent of the other party to the contract.
- **Finance:** Any profits must be shared by the partners.
- **Control** is also shared by the partners and any conflicts or differences between the firms can lead to the alliance splitting up before it has had time to become successful. Speed of expansion can be delayed due to the need for greater communications and shared decision-making between the firms involved. Disagreements can arise over the sharing of costs.

Signpost:
For more information on strategic alliances, see **Chapter 17: Business Expansion**

8. What is franchising?

Franchising *means the renting of a complete business formula, including business name, logo and products/services to someone else.* Franchising is becoming more common in service businesses such as retailing as it is a relatively easy way for entrepreneurs to set up their own business.

Example: Examples include Abrakebabra, Supermac's, Starbucks, Costa Coffee and CrossFit Gyms.

- The **franchiser** *owns the business formula and rents it to the franchisee in return for a share of the sales*. If the franchisee breaks the terms of the franchise, then the franchiser can withdraw permission to use the business name, idea and products and cancel the contract.
- The **franchisee** *is the person who rents the business idea and can only run it according to strict rules set down by the franchiser and in exchange for a share of the sales*.

Evaluation of operating as a franchise

Advantages

- **Formation:** For the franchisee, renting a business idea with a proven track record and ready-made brand image makes setting up a business easier. It can be dissolved by cancelling the contract with the franchiser.
- **Finance:** For the franchiser, it is a low-cost method of expansion as most of the start-up finance is provided by the franchisee.
- **Risk:** It is relatively low risk to the franchiser because if a franchisee breaks the conditions attached, the contract can be cancelled. It is also low risk for the franchisee as they are taking on a proven business.
- **Control:** Ownership of the business idea remains with the franchiser who can withdraw the franchise if they are unhappy with the franchisee. The franchisee receives training, advice and other support from the franchiser firm, which can allow rapid business start-up and expansion.

Disadvantages

- **Finance:** The franchisee must put up most of the finance and take most of the financial risk when taking out a franchise. The franchiser receives an annual royalty fee based on a percentage of sales but misses out on the full amount of profit that could be earned if they retained full ownership themselves.
- **Risk**: An unsuitable franchisee can damage the reputation of the whole business.
- **Control:** For the franchisee, there is no ultimate ownership or control over the business. The franchisee has little real independence in the management of the business. For the franchiser, control is lost over the day-to-day management of franchise outlets.

Fieldwork

1. Identify the three nearest franchise businesses to your school.
2. Select **one** of them and research online to identify how an entrepreneur could take out a franchise.

9. Why do businesses change their ownership structure over time?

Most new businesses start off as sole traders or partnerships. As they grow, their financial requirements and level of risk can change and they may decide to become co-operatives or limited companies. Subsequent growth may mean that companies and co-ops further alter their legal structure by becoming public limited companies. Businesses often change their legal structures to meet the changing needs of the business and its owners. The main reasons for changing legal structures are:

- **To raise new finance:** This is the most common reason for changing the legal structure of a business. Sole traders can raise finance by going into partnership. Sole traders and partnerships can become private limited companies in order to sell shares to raise additional finance or reduce their business risks. If a private limited company (or commercial state company) needs to raise very large amounts of finance, it may apply to the stock exchange to become a public limited company (PLC).

- **To acquire new skills:** Sole traders often change into partnerships to share the workload and also to benefit from the new partners' skills and expertise. If a firm becomes a limited company, it can attract, motivate and reward skilled staff by offering them shares in the business.
- **To lower the risk for the owners:** As a business grows and the possible risks increase, sole traders and partnerships can become limited liability companies (or co-ops) to get the protection of limited liability for their owners.
- **To increase sales and profits:** Forming a strategic alliance with another company can give a business the ability to sell more products, leading to increased business for both. Moving from a sole trader or partnership to a private limited company, or from a private limited company to a PLC can enhance the image and reputation of a business, making advertising, public relations and other promotions more effective.
- **Regain control:** Some owners who turn their firms into limited companies and PLCs to raise finance regret the loss of ownership and control that can occur. They may then buy back the shares they sold and turn the business back into a private limited company. This is what Richard Branson did with his Virgin business (see Case Study below).

Some businesses change their legal structures over time to help them raise new finance, bring in new skills or reduce the risks involved in business expansion.

Case Study: Virgin changes its legal structure . . . again… and again

Richard Branson started off in business as a simple **sole trader**. As the business grew, he considered turning it into a **partnership** but decided instead to set up a **private limited company**, which he called Virgin Ltd.

When Branson decided to start an airline, he needed to raise very large amounts of money. He decided to raise **equity finance** by converting Virgin into a **public limited company** (PLC) and selling some of his shares on the stock market. This is known as a **stock market flotation** or '**going public**'.

However, Branson became frustrated with the attitude of the new shareholders who were just interested in short-term profits instead of long-term growth. So, using his own money, he bought back the shares he had previously sold on the stock market and returned Virgin to being a private limited company again. This is known as '**going private**'.

Recall and Review

1. For Branson, what was the big advantage of changing from a private limited company into a PLC?
2. What was the big advantage in changing the legal structure back into a private limited company?
3. Do you think Branson would have been able to start his airline if he was a sole trader? If he had tried, what problems do you think he would have run into?

10. What are the main trends in business ownership structures?

Bigger firms taking over smaller firms

There is a global trend for large global firms to take over smaller firms and dominate different industries and markets. When one firm takes over another, the smaller firm will usually become a subsidiary of the larger firm.

A subsidiary is a company that is more than 50% owned by another company. There are approximately 80,000 multinational corporations around the world who, in turn, own more than 800,000 subsidiary firms.

Privatisation and nationalisation of companies

Generally, the number of **commercial** state-owned companies has been declining as governments adopted a policy of privatisation. Formerly state-owned enterprises such as Aer Lingus, Eir and Greencore were sold off to private investors and very few new commercial state-owned companies have been established.

> Example: After a period of reckless lending and financial mismanagement in the early 2000s, the Irish State had to use taxpayers' money to fully or partially nationalise a number of banks including AIB and Bank of Ireland to prevent them collapsing and damaging the wider economy.

Most new commercial state enterprises that are undertaken are done so as joint ventures with the private sector. These are known as **public-private partnerships.**

> Example: A number of motorways in Ireland have been built by the private sector. In return, they are allowed to charge tolls on the motorways in order to make a profit from the deal.

Increase in strategic alliances

Many Irish firms are entering into strategic alliances such as joint ventures with other firms. Such an approach allows firms to achieve greater economies of scale, share risks and compete more effectively in an increasingly globalised economy.

> Example: Glanbia entered into a strategic alliance with a Dutch company to build a factory in County Kilkenny and produce specialist cheese such as Edam and Emmental for European markets.

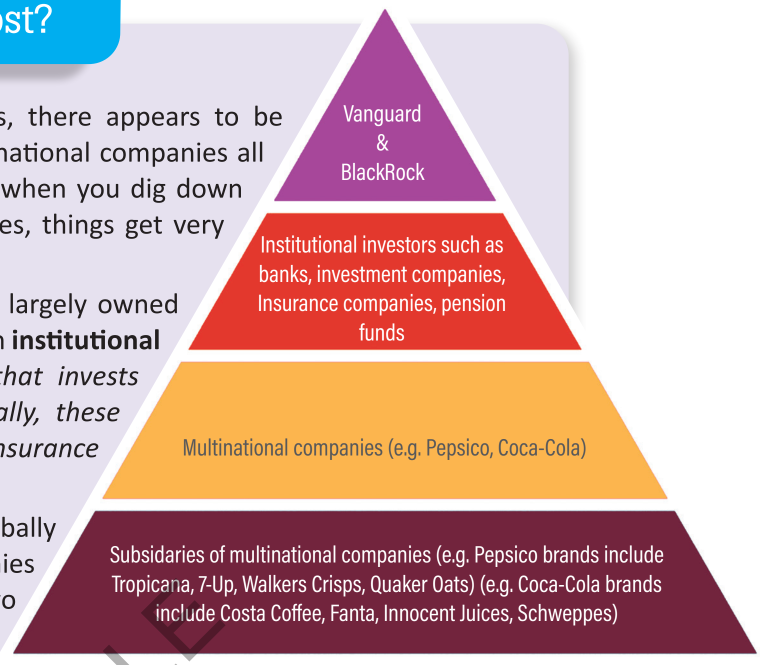
Growth of franchising

Franchising has become a very common method of business expansion for many service firms, such as Supermac's and McDonald's, as it allows firms to expand rapidly in a competitive market at relatively low cost and risk. As a way of setting up or expanding a business, franchising is likely to be very important in the 21st century.

Emergence of Irish Transnational Corporations (TNCs)

Irish firms like Fyffes and Kerry Group have set up operations in many different countries across the globe due to the growth of free trade, membership of the EU and the small size of the Irish market. Such firms are described as **transnational** (or multinational) businesses. Coming in the opposite direction, an even larger number of foreign-owned TNCs have located their operations in Ireland to take advantage of our low company tax rates, membership of the EU, well-educated population and availability of State grants.

Case Study: Who owns the most?



When you look at the world of business, there appears to be thousands of different transnational/multinational companies all competing in different markets. However, when you dig down into who actually owns all these companies, things get very interesting.

The shares of big global companies are largely owned by what are called institutional investors. An **institutional investor** *is a company or organisation that invests money on behalf of other people. Typically, these are investment funds, pension funds, insurance companies and banks.*

The two biggest institutional investors globally are two colossal investment companies called **BlackRock** and **Vanguard.** These two corporations directly own trillions of euros worth of shares across most of the biggest multinational companies. On top of that, BlackRock and Vanguard also own large shareholdings in most of the other large institutional investors. This direct and indirect ownership network often allows them to have their representatives appointed to the boards of directors of these large companies.

This means that large global companies, like Pepsi and Coca-Cola, despite being competitors have largely the same owners because most of their shares are owned either directly or indirectly by BlackRock and Vanguard.

This same pattern of direct and indirect share ownership by BlackRock and Vanguard applies across all major industries, from banking and technology, to pharmaceuticals, food and media. As a result, these two companies have a significant stake in all the major industries in the world and have trillions of euros in wealth.

Here's a final twist. Who owns BlackRock? The biggest shareholder is actually Vanguard.

Who owns Vanguard? Vanguard states it is 'owned by the people who invest in our funds.'

Recall and Review

1. BlackRock is a public limited company (PLC). Vanguard is a private limited company. Explain the difference between these two types of legal structure.
2. Create a mind map summarising the main points in this chapter.

Signpost:
For more information on privatisation and nationalisation, see **Chapter 22: Government & Business**

Signpost:
For more information on transnational corporations, see **Chapter 25: Global Business**

Key Concepts & Business Terms: After studying this chapter the student should be able to explain the following key concepts and business terms:

1. Sole trader
2. Unlimited liability
3. Partnership
4. Deed of partnership
5. Company limited by shares
6. Limited liability
7. Continuity of existence
8. Companies Registration Office (CRO)
9. Shareholders
10. Company Constitution
11. Annual General Meeting (AGM)
12. Board of directors
13. Managing director/chief executive officer (CEO)
14. Company chairperson
15. Company secretary
16. Co-operative
17. State-owned companies
18. Stock market flotation/going public
19. Strategic alliances
20. Franchising
21. Institutional investor

Go to page 107 of your **Business Express Workbook** for more activities on **Types of Business Organisation**.

Leaving Certificate Practice Questions

Ordinary Level

Ordinary Level – Section 1 – Short Questions (10 marks each)

1. As a type of business organisation, describe **three** features of a sole trader. **[LCQ]**
2. Explain the term 'partnership'. **[LCQ]**
3. List **one** advantage and **one** disadvantage of a partnership structure.
4. Explain the purpose of a deed of partnership.
5. Define 'limited liability'. **[LCQ]**
6. Outline the role of the Companies Registration Office (CRO).
7. What does the term 'CEO' mean? **[LCQ]**
8. What is a Company Constitution? **[LCQ]**
9. Describe **two** merits of a co-operative as a form of business organisation. **[LCQ]**
10. List **two** reasons why a business may change its legal structure over time.
11. List **three** reasons why a private limited company would expand to become a public limited company. **[LCQ]**
12. Explain the term 'franchising' and illustrate your answer with an example. **[LCQ]**

Ordinary Level – Section 2 – Long Questions

1. Give **two** benefits of a partnership as a type of business organisation. *(20)*
2. List **three** benefits for an entrepreneur in forming a private limited company. *(15)* **[LCQ]**
3. People in a company include shareholders, directors, auditors and a company secretary. Explain the role of any **two** of these people. *(20)* **[LCQ]**
4. Discuss the benefits of setting up in business as a private limited company. *(20)*
5. Outline the steps involved in forming a limited company. *(20)*
6. Define what the term 'shareholders' means. *(15)* **[LCQ]**
7. Describe the role of the board of directors in a company. *(15)* **[LCQ]**
8. Outline **three** trends affecting business ownership and structure in Ireland. *(15)*
9. Explain the advantages of franchising for the franchisee and the franchiser. *(20)*
10. Outline **four** reasons why a business may change its legal structure over time. *(20)*

Higher Level

Higher Level – Section 1 – Short Questions (10 marks each)

1. List **three** advantages that a partnership has over a sole trader as a legal structure.
2. Explain the purpose of a Company Constitution when forming a limited company.
3. Distinguish between a private limited company and a public limited company.
4. Identify **two** advantages of setting up in business as a co-op.
5. What is the role of the managing director in a company?
6. A worker co-operative is . . .
7. Identify the type of company that can sell its shares on the stock market.
8. Distinguish between a state-owned company and a PLC.

Higher Level – Section 2 – Applied Business Question

Case Study: Molly Malone's Irish restaurant

Gráinne O'Neill opened a traditional Irish restaurant called Molly Malone's several years ago. An excellent chef, she started off as a sole trader and steadily built up a good reputation for the business. The restaurant became very popular, particularly with tourists, and during the summer season it often had to turn away bookings.

MOLLY MALONE'S
IRISH RESTAURANT

When Gráinne needed to expand her business to cope with the increasing trade, she decided to bring in a business partner, Trevor, to provide the extra finance and people management skills that the business now required. Although they have very different management styles, the two have worked well together most of the time and share the workload and decision-making. When one is ill, the other partner is able to continue running the restaurant. Profits are split 60% to Gráinne, 40% to Trevor who is saving up some of his profits to pursue his dream of someday moving to Australia and opening a beach restaurant. With the help of retained earnings and a bank loan, the business has now expanded to include two more restaurants, and has a combined turnover of over €5 million a year.

Gráinne and Trevor would like to open more restaurants but do not have the finance to do so. They are also aware that as a business grows, so too does the risk. Given the success of the existing restaurants, they are also interested in expanding the business abroad, especially in the US and Germany where they feel there is a demand for traditional Irish restaurants. It has been suggested to them that they consider franchising as a possible route for this expansion.

1. Evaluate the potential risks and benefits of operating the restaurant as a partnership. Refer to the text in your answer. *(20)*
2. Assess the potential benefits for Trevor and Gráinne of changing their business partnership into a company limited by shares. Refer to the text in your answer. *(30)*
3. Explain how Gráinne and Trevor could use franchising to expand the business. *(30)*

Higher Level – Section 3 – Long Questions

1. Evaluate the legal ownership options open to an entrepreneur seeking to expand his/her enterprise. *(20)*
2. Compare a private limited company with a partnership as desirable forms of business organisation. *(25)* **[LCQ]**
3. Explain why you would recommend a private limited company as a type of business organisation for a new business venture. *(20)* **[LCQ]**
4. Explain the steps involved in setting up a private limited company. *(20)*
5. Draft the agenda for an AGM of a private limited company. *(15)* **[LCQ]**
6. Contrast a private limited company with a public limited company as a form of business organisation. *(20)* **[LCQ]**
7. Distinguish between the role of directors and shareholders in a company. *(20)*
8. Contrast a business alliance with a franchise as forms of business organisation. Use examples in your answer. *(20)* **[LCQ]**
9. Describe **two** reasons why a business enterprise might change its organisational structure over time. Use illustrations to support your answer. *(20)* **[LCQ]**