Cambridge

IGCSE / O-Level

Business Studies

(Code: 0452 / 7707)

Unit 01

Understanding Business

Activity

1.4 Types of business organization

Business organizations the private sector

There are several main forms of business organization in the private sector. These are:

» Sole traders
» Partnerships
» Private limited companies
» Public limited companies
» Franchises
» Joint ventures.

Sole traders

A sole trader is a business owned by one person. It is a business owned and operated by just one person. There are only a few legal regulations which must be followed:

» The owner must register with, and send annual accounts to, the Government Tax Office.

» The name of the business is significant. In some countries the name must be registered with the Registrar of Business Names.

» In some industries, the sole trader must observe laws which apply to all businesses in that industry.

Disadvantages of being a sole trader

Limited liability means that the liability of shareholders in a company is limited to only the amount they invested.

Unlimited liability means that the owners of a business can be held responsible for the debts of the business they own. Their liability is not limited to the investment they made in the business.

Partnerships

Partnership is a form of business in which two or more people agree to jointly own a business. The partners will contribute to the capital of the business, will usually have a say in the running of the business and will share any profits made.

A partnership agreement is the written and legal agreement between business partners. It is not essential for partners to have such an agreement, but it is always recommended.

Advantages of a partnership

• More capital could now be invested into the business from Gita's savings, and this would allow expansion of the business. Additional taxis could now be purchased.

• The responsibilities of running the business were now shared. Gita specialized in the accounts and administration of the business.

• Both partners were motivated to work hard because they would both benefit from the Profits.

Disadvantages of a partnership

• The partners did not have limited liability.

• An unincorporated business is one that does not have a separate legal identity

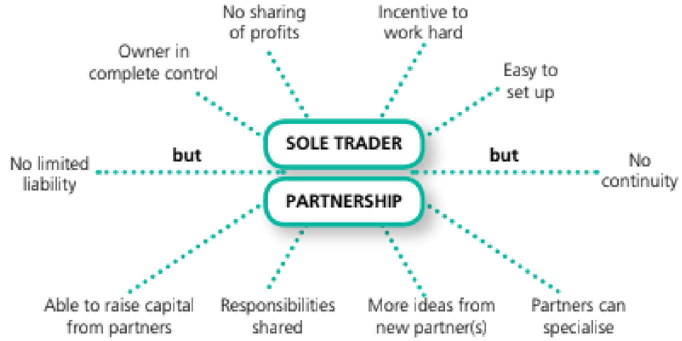
• Partners can disagree on business decisions and consulting all partners takes time.

• If one of the partners is very inefficient or dishonest, then the other partners could suffer by losing money in the business.

• Most countries limit the number of partners to 20 and this means that business growth would be limited by the amount of capital that 20 people could invest.

Limited partnerships

In some countries it is possible to create a Limited Liability Partnership. The abbreviation for this new form of legal structure is LLP.



Private limited companies

There is one essential difference between a company and an unincorporated business,

1) **Incorporated businesses** are companies that have a separate legal status from their owners.
2) **Shareholders** are the owners of a limited company. They buy shares which represent part- ownership of the company.
3) **Private limited companies** are businesses owned by shareholders, but they cannot sell shares to the public.

Advantages of a private limited company

• Shares can be sold to many people (in some countries there is a maximum number). These would be likely to be friends or relatives of Mike and Gita – they could not advertise the shares for sale to the public.

• All shareholders have limited liability. This is an important advantage. It means that if the company failed with debts owing to creditors, the shareholders could not be forced to sell their possessions to pay the debts.

• The people who started the company – Mike and Gita in our example – can keep control of it if they do not sell too many shares to other people.

• Both documents are intended to make sure that companies are correctly run and to reassure shareholders about the purpose and structure of the company.

• The shares in a private limited company cannot be sold or transferred to anyone else without the agreement of the other shareholders. This rule can make some people reluctant to invest in such a company.

• The accounts of a company are less secret than for either a sole trader or a partnership. Each year the latest accounts must be sent to the Registrar of Companies and members of the public can inspect them. Mike and Gita must be prepared to allow more information about their business to be known to other people.

• Most importantly for rapidly expanding businesses, the company cannot offer its shares to the public. Therefore, it will not be possible to raise really large sums of capital to invest back into the business.

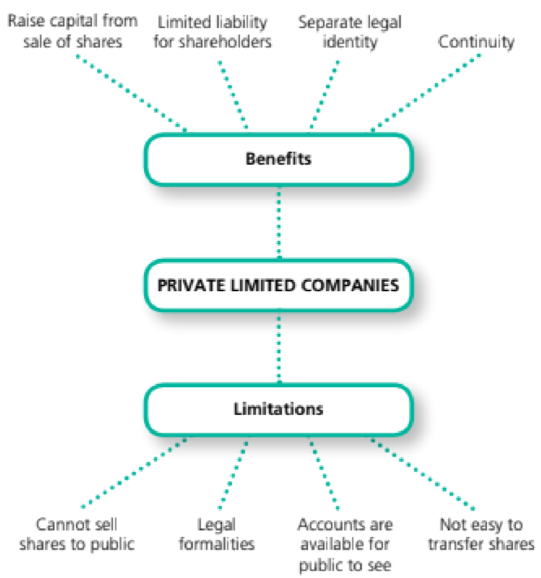
Disadvantages of a private limited company

• There are significant legal matters which must be dealt with before a company can be formed. Two important forms or documents must be sent to the Registrar of Companies.

• The Articles of Association – this contains the rules under which the company will be managed – the rights and duties of all the directors.

• The Memorandum of Association – this contains very important information about the company and the directors. The official name and the address of the registered offices of the company must be stated.

Private limited companies



Public limited companies

Public limited companies are businesses owned by shareholders, but they can sell shares to the public and their shares are tradeable on the Stock Exchange.

1) Public limited company are not in the public sector of industry, as many students believe. They are not owned by the government but by private individuals and as a result they are in the private sector.

2 The title given to public limited companies can cause confusion. This is why in the UK, public limited companies are given the title 'plc' after the business name, this must not be confused with the UK use of 'Limited' which refers only to private limited companies.

A public limited company has certain advantages and disadvantages.

Advantages of a public limited company

» This form of business organization still offers **limited liability** to shareholders.

» It is an **incorporated business** and has a separate legal identity to the owners or shareholders. Its accounts are kept separately from those of the owners and there is continuity should one of the shareholders die.

» There is now the opportunity to raise **very large capital sums** to invest in the business. There is no limit to the number of shareholders a public limited company can have.

» There is no restriction on the **buying, selling** or **transfer** of shares.

» A business trading as a public limited company usually has high status and should find it easier to attract suppliers prepared to sell goods on credit and banks willing to lend to it than other types of businesses.

Disadvantages of a public limited company

» The **legal formalities** of forming such a company are quite complicated and time-consuming.

» There are many **more regulations** and **controls** over public limited companies to try to protect the interests of the shareholders. These include the publication of accounts, which anyone can ask to see.

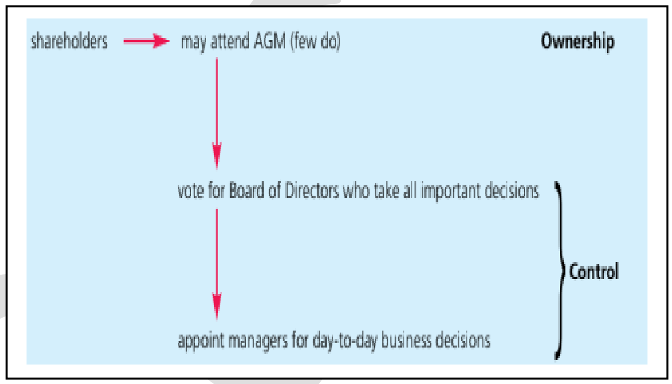
» **Selling shares to the public is expensive**. The directors will often ask a specialist merchant bank to help them in this process. It will charge a commission for its services.

» There is a very real danger that although the original owners of the business might become rich by selling shares in their business, they may lose control over it when it 'goes public'.

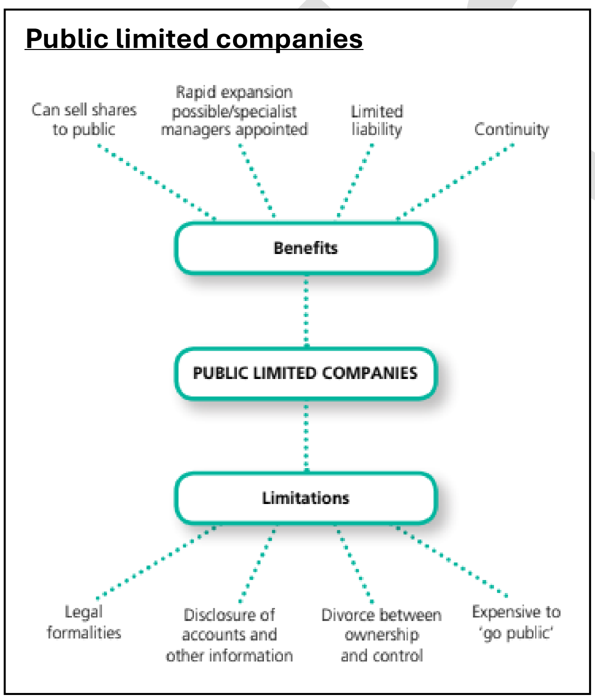
<u>Control and ownership in a public limited company.</u>

In all sole trader businesses and partnerships, the owners have control over how their business is run. They take all the decisions and try to make the business achieve the aims that they set. This is also the case in most private limited companies which have relatively few shareholders.

An Annual General Meeting is a legal requirement for all companies. Shareholders may attend and vote on who they want to be on the Board of Directors for the coming year.



Dividends are payments made to shareholders from the profits (after tax) of a company. They are the return to shareholders for investing in the company.



Risk, ownership and limited liability – summary

Business organisation	Risk	Ownership	Limited liability
Sole trader	Carried by sole owner	One person	No
Partnership	Carried by all partners	Several partners	No
Private limited company	Shareholders up to their original investment	Shareholders – may be few or many but shares cannot be sold to the public	Yes
Public limited company	Shareholders up to their original investment	Shareholders – many (may be millions!)	Yes

Other private sector business organizations

Two other types of private sector business organization exist.

Franchising

A franchise is a business based upon the use of the brand names, promotional logos, and trading methods of an existing successful business. The franchisee buys the license to operate this business from the franchisor.

	To the franchisor	To the franchisee
Advantages	• The franchisee buys a licence from the franchisor to use the brand name • Expansion of the franchised business is much faster than if the franchisor had to finance all new outlets • The management of the outlets is the responsibility of the franchisee • All products sold must be obtained from the franchisor	• The chances of business failure are much reduced because a well-known product is being sold • The franchisor pays for advertising • All supplies are obtained from a central source – the franchisor • There are fewer decisions to make than with an independent business – prices, store layout and range of products will have been decided by the franchisor • Training for staff and management is provided by the franchisor • Banks are often willing to lend to franchisees due to relatively low risk
Disadvantages	• Poor management of one franchised outlet could lead to a bad reputation for the whole business • The franchisee keeps profits from the outlet	• Less independence than with operating a non-franchised business • May be unable to make decisions that would suit the local area, for example, new products that are not part of the range offered by the franchisor • Licence fee must be paid to the franchisor and possibly a percentage of the annual turnover

Joint ventures

A **joint venture** is where two or more businesses start a new project together, sharing capital, risks, and profits.

Advantages of joint ventures	Disadvantages of joint ventures
Sharing of costs – very important for expensive projects such as new aircraft	If the new project is successful, then the profits have to be shared with the joint venture partner
Local knowledge when joint venture company is already based in the country	Disagreements over important decisions might occur
Risks are shared	The two joint venture partners might have different ways of running a business – different cultures

Business organizations in the public sector

The public sector is a very important part of the economy of all mixed economies. The term ‘public sector’ includes all businesses owned by the government/state and local government, and public services such as hospitals, schools, fire services and government departments.

Public corporations

A public corporation is a business in the public sector that is owned and controlled by the state.

Advantages of public corporations

» Some industries are considered so important that government ownership is thought to be essential. These include water supply and electricity generation in many countries.

» If industries are controlled by monopolies because it would be wasteful to have competitors – two sets of railway lines to a certain town.

» If an important business is failing and likely to collapse, the government can step in to nationalize it. This will keep the business open and secure jobs.

» Important public services, such as TV and radio broadcasting, are often in the public sector. Non-profitable but important programs can still be made available to the public.

Disadvantages of public corporations

» There are no private shareholders to insist on high profits and efficiency. The profit motive might not be as powerful as in private sector industries.

» Government subsidies can lead to inefficiency as managers will always think that the government will help them if the business makes a loss. It may also be unfair if the public corporation receives a subsidy but private firms in the same industry do not.

» Often there is no close competition between the public corporations. There is therefore a lack of incentive to increase consumer choice, increase efficiency or even improve customer service.

» Governments can use these businesses for political reasons, for example, to create more jobs just before an election. This prevents the public corporations operating like other profit-making businesses.

Other public sector enterprises

Local government authorities or municipalities usually operate some trading activities. Some of these services are free to the user and paid for out of local taxes, such as street lighting and schools. Other services are charged for and expected to break even at least.

1.5 Business objectives and stakeholder objectives

Need for and importance of business objectives.

An **objective** is an aim or a target to work towards. All businesses should have objectives. b**usiness objectives** are the aims or targets that a business works towards.

» They give workers and managers a clear target to work towards and this helps motivate people.

» Taking decisions will be focused on: 'Will it help achieve our objectives?'

» Clear and measurable objectives help unite the whole business towards the same goal.

» Business managers can compare how the business has performed to their objectives – to see if they have been successful or not.

Different business objectives

Objectives are often different for different businesses. A business may have been formed by an entrepreneur to provide employment and security for the owner or his/her family.

The most common objectives for businesses in the private sector are to achieve:

» Business survival

» Profit

» Returns to shareholders.

» Growth of the business.

» Market share

» Service to the community.

Survival

When a business has recently been set up, or when the economy is moving into recession, the objectives of the business will be more concerned with survival than anything else. else. New competitors can also make a business feel less secure.

Profit

Profit is total income of a business (revenue) fewer total costs. Profits are needed to:

» Pay a return to the owners of the business for the capital invested and the risk taken.

» Provide finance for further investment in the business.

Returns to shareholders.

The managers of companies

will often set the objective of ‘increasing returns to shareholders. Returns to shareholders are increased in two ways:

» Increasing profit and the share of profit paid to shareholders as dividends.

» Increasing share price – managers can try to achieve this not just by making profits but by putting plans in place that give the business a good chance of growth and higher profits in the future.

Growth

The owners and managers of a business may aim for growth in the size of the business. – usually measured by value of sales or output – to:

» Make jobs more secure if the business is larger.

» Increase the salaries and status of managers as the business expands.

» Open new possibilities and help to spread the risks of the business by moving into new products and new markets.

» Obtain a higher market share from growth in sales.

» Obtain cost advantages, called economies of scale, from business expansion.

Market share

Market share is the percentage of total market sales held by one brand or business.

If the total value of sales in a market is $100 million in one year and Company A sold $20 million, then Company A’s market share is 20 per cent.

$$\text{Market share \%} = \frac{\textit{Company sales}}{\textit{Total market sales}} \times 100$$

Increased market share gives a business:

» Good publicity, as it could claim that it is becoming ‘the most popular.’

» Increased influence over suppliers, as they will be very keen to sell to a business that is becoming relatively larger than others in the industry.

» Increased influence over customers

Providing a service to the community – the objectives of social enterprises

A social enterprise has social objectives as well as an aim to make a profit to reinvest back into the business.

» Social: to provide jobs and support for disadvantaged groups in society, such as the disabled or homeless.

» Environmental: to protect the environment.

» Financial: to make a profit to invest back into the social enterprise to expand the social work that it performs.

The main internal and external stakeholder groups and their objectives

The following groups of people are involved in business activity in one way or another, or are affected by it:

» Owners » Workers » Banks.

» Managers » Consumers

» Government » The whole community

A stakeholder is any person or group with a direct interest in the performance and activities of a business.

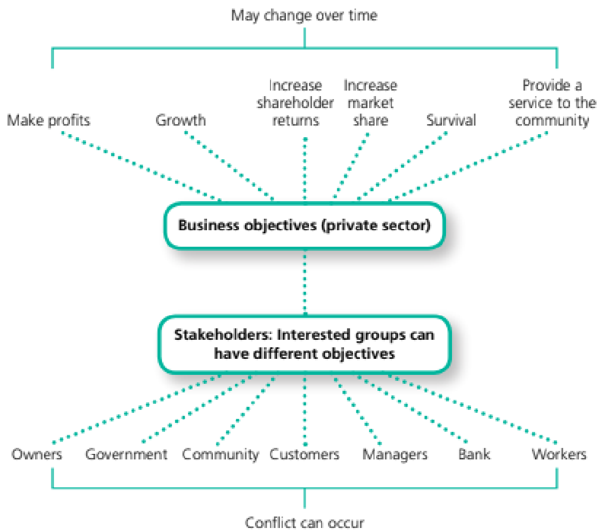
Objectives of public sector businesses

» Financial: Meet profit targets set by government – sometimes the profit is reinvested back in the business and on other occasions it is handed over to the government as the ‘owner’ of the organization.

» Service: Provide a service to the public and meet quality targets set by government.

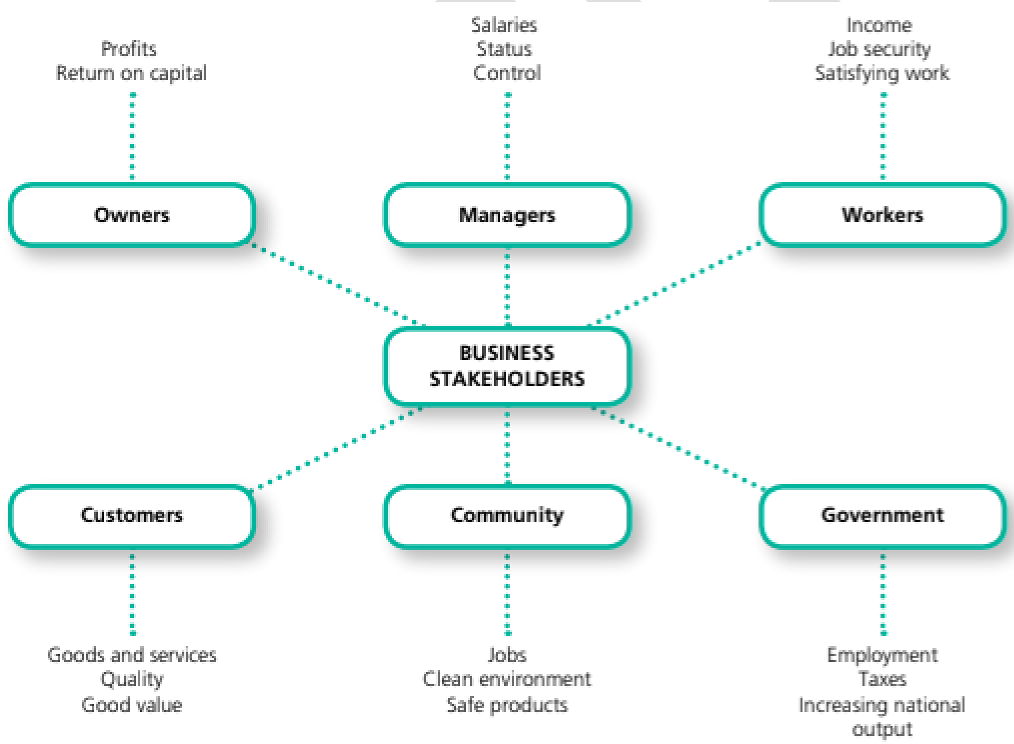
» Social: Protect or create employment in certain areas – especially poor regions with few other business employers.

Business objectives (private sector)



Conflict of stakeholders' objectives

Business stakeholders and their aims



7115/21

October/November 2023

1) (a) Explain two advantages and two disadvantages of PH being a public limited company.

(b) Consider the following two ways PH could ensure quality production. Which way should PH choose? Justify your answer. • Quality control • Quality assurance

2) (a) Explain two limitations and two benefits to a business of developing new products.

(b) Consider the advantages and disadvantages of the following three methods PH uses to collect market research data. Which method is most likely to ensure that accurate data is collected? Justify your answer.

• A focus group made up of existing customers

• An online survey with only 5 questions

• Secondary research including government sources

3) (a) Explain two reasons why training is important to PH

(b)Consider how the following three groups might use the financial data shown in Appendix 3. Which group will find this data most useful? Justify your answer.

• PH's employees

• PH's shareholders

• Competitor considering taking over PH

4) (a) Explain two benefits of PH's employees becoming members of a trade union

(b) Consider three possible benefits for PH of becoming a multinational company. Which benefit is likely to be the most important? Justify your answer.

5)PH is a large public limited company based in country Z. It has been operating successfully for 50 years. PH produces a range of protective hats for employees working on construction sites, in factories or mines. It has a reputation for producing high-quality products and sells its hats around the world.

PH is currently the market leader in country Z. To remain competitive PH regularly carries out market research to find out if new products are needed. PH needs to ensure its market research data is accurate, so that it can develop the best new protective hats. PH's only factory is in country Z. It has 100 production employees. They work on a flow production line and carry out the same tasks every day. PH pays these employees the minimum wage and there have been complaints about working conditions. Some of the employees are considering becoming members of a trade union.

PH’s directors plan to expand the company by opening factories in other countries to produce protective hats. They think there are many benefits for PH of becoming a multinational company. They are aware that there is growing demand for protective hats in many developing countries where construction and manufacturing industries are expected to continue to have strong growth in the next 10 years.

Appendix 1

Advertisement for PH’s products

PH’s protective hats will protect your employees when at work.

We supply many of the leading construction, manufacturing, and mining companies across the world.

High quality is guaranteed.

PH’s hats can be ordered online from our website.

Appendix 2

Email to PH’s Managing Director from PH’s Human Resources Director

To: Managing Director

From: Human Resources Director

Date: 1 October 2023

Re: Training

After reviewing our current training, I think we need to increase the training we provide to new employees. Existing employees would also benefit from additional training as there have been issues with motivation. I know there are plans to introduce new equipment into the flow production line. When is this likely to happen? Can we please meet to discuss these issues?

Appendix 3

PH's financial data for 2021 and 2022

	2021	2022
Revenue	$100m	$125m
Profit	$20m	$20m
Gross profit margin	60%	65%
Profit margin	20%	16%

6) TBX manufactures high-quality steel which is used to build railways. The method of production used allows TBX to benefit from economies of scale. The business holds a high level of inventory including iron ore. The Managing Director knows business activity could have an impact on the environment and is considering ways the business can contribute to sustainable development.

(a) Identify two ways business activity could have an impact on the environment.

(b) Identify two ways a business could contribute to sustainable development

(c) Outline two possible economies of scale TBX might benefit from.

(d) Explain two possible problems for TBX of holding a high level of inventory.

(e)Do you think quality control is the best method for a manufacturing business to use to achieve quality production? Justify your answer.

7) Country X has a mixed economy with both private and public sector organizations. These organizations are involved in different sectors of economic activity. In the last 20 years the primary sectors have become less important to country X's economy. A summary of the changes is shown in Table 3.1. The government is planning to encourage multinational companies to set up factories in country X.

Table 3.1

Economic sectors in country X as a percentage of GDP			
Year	Primary	Secondary	Tertiary
2000	60%	15%	25%
2020	20%	30%	50%

(a) Define 'public sector'

(b) Define 'gross domestic product' (GDP).

(c) Identify four types of business organization in the private sector.

(d)Using the data from Table 3.1, explain two possible reasons for the changing importance of the primary sector in country X.

(e)Do you think the benefits to a country of having a multinational company located there are always greater than the drawbacks? Justify your answer.