What is a business organisation?

Businesses are often referred to as organisations. An ORGANISATION is a body that is set up to meet needs. For example, the St. John's Ambulance organisation was originally set up by volunteers to train the public in life saving measures.

Business organisations satisfy needs by providing people with goods and services. All organisations will:
- try to achieve objectives;
- use resources;
- need to be directed;
- have to be accountable;
- have to meet legal requirements;
- have a formal structure.

Private sector business organisations

One method of classifying businesses is by sector. The PRIVATE SECTOR includes all those businesses which are set up by individuals or groups of individuals. Most business activity is undertaken in the private sector. The types of business in the private sector can vary considerably. Some are small retailers with a single owner. Others are large multinational companies such as Cadbury Schweppes. Businesses will vary according to the legal form they take and their ownership.

- Unincorporated businesses. These are businesses where there is no legal difference between the owners and the business. Everything is carried out in the name of the owner or owners. These firms tend to be small, owned by either one person or a few partners.
- Incorporated businesses. An incorporated body is one which has a separate legal identity from its owners. In other words, the business can be sued, can be taken over and can be liquidated.

Figure 1 shows the different types of business organisation in the private sector, their legal status and their ownership. These are examined in the rest of this unit.

Sole traders

The simplest and most common form of private sector business is a SOLE TRADER or SOLE PROPRIETOR. This type of business is owned by just one person. The owner runs the business and may employ any number of people to help.

Sole traders can be found in different types of production. In the primary sector many farmers and fishermen operate like this. In the secondary sector there are small scale manufacturers, builders and construction firms. The tertiary sector has large numbers of sole traders. They supply a wide range of services, such as hairdressing, retailing, restaurants, gardening and other household services. Many sole traders exist in retailing and construction, where a very large number of shops and small construction companies are each owned by one person.

Although there are many more sole traders than any other type of business, the amount they contribute to total output in the UK is relatively small.

Setting up as a sole trader is straightforward. There are no legal formalities needed.

However, sole traders or self-employed entrepreneurs do have some legal responsibilities once they become established. In addition, some types of business need to obtain special permission before trading.

- Once turnover reaches a certain level sole traders must register for VAT.
- They must pay income tax and National Insurance contributions.

Figure 1: Business organisations in the private sector

- Private sector business organisations
- Unincorporated businesses
  - Sole trader (One owner)
  - Partnership (Owned by partners)

- Incorporated businesses
  - Private limited company (Owned by a few shareholders)
  - Public limited company (Owned by many shareholders)
Question 1.

Joanna Carter owns Joanna Carter Contemporary Flowers in Wallingford. She attracts customers in three areas - weddings, corporate work for local business and flowers for private homes. Despite only setting up in July last year, demand has soared thanks to Joanna’s growing reputation for creative arrangements. She set up as a sole trader after leaving her job to raise a family. “After leaving my personnel job to have my children, now aged nine and six, I had time to think about where I really wanted to go in my career. I was keen to develop my passion for flowers with proper training and so I took a two-year part-time course at Abingdon and Witney College”. She also gained work experience working one day a week in a florists’ shop in Wallingford. When she graduated, she had already received a number of offers from people wanting her to do private arrangements for them. So she left the shop to run her own business from home. Joanna approached the local Business Link, a free and impartial guide to business advice, resources and information shortly after setting up the business. “I’ve been able to book a place on an advanced bridal skills course with highly respected London florist Jane Packer in May. The course costs £900 and half of the cost will be paid for through the Skills Development Team at Business Link. I am also looking into a broadband grant so I can provide a slide show of my work for potential corporate customers and wedding bookings. I’m in the process of applying for an Enterprising Woman grant run by Surrey University which will give me £350 worth of funding”.

Source: adapted from www.businesslink.gov.uk.

(a) As a sole trader Joanna Carter has unlimited liability. What does this mean?
(b) Explain two advantages to Joanna Carter of operating as a sole trader.
(c) How did Business Link help Joanna Carter in running her small business?

- The owner is in complete control and is free to make decisions without interference. For many sole traders independence is one of the main reasons why they choose to set up in business.
- The owner has flexibility to choose the hours of work he or she wants and to take holidays. Customers may also benefit. Sole traders can take individual customers’ needs into account, stocking a particular brand of a good or making changes to a standard design, for example.
- Because of their small size, sole traders can offer a personal service to their customers. Some people prefer to deal directly with the owner and are prepared to pay a higher price for doing so.
- Such businesses may be entitled to government support.

Disadvantages of sole traders

However, there are also disadvantages of sole traders.
- Sole traders have UNLIMITED LIABILITY. This means that if the business has debts, the owner is personally liable. A sole trader may be forced to sell personal possessions or use personal savings to meet these debts.
- Sole proprietorships can be risky for their owners. If the business is unsuccessful, sole traders can end up working for nothing or even subsidising the business out of their own private resources. Also, because the business is the sole trader, long term illness can have a devastating effect on it. Becoming an employee is less risky and is one reason why workers may not want to work for themselves.
- Sole proprietorships face continuity problems. Will the business survive if the sole trader dies, takes retirement or decides to do something different? Some sole traders run family businesses where parents tend to pass on their business to their children. Farming is an example. However, many sole traders will not pass their businesses on to family members. So these businesses will disappear.
- The money used to set up the business is often the owner’s savings. It may also come from a bank loan. Sole traders may find it difficult to raise money. They tend to be small and lack sufficient collateral, such as property or land, on which to raise finance. This means money for expansion must come from profits or savings.
- Independence is an advantage, but it can also be a disadvantage. A sole trader might prefer to share decision making, for example. Many sole traders work very long hours, without holidays, and may have to learn new skills.
- In cases where the owner is the only person in the business, illness can stop business activity taking place. For example, if a sole trader is a mobile hairdresser, illness will lead to a loss of income in the short term, and even a loss of customers in the long term.
- Because sole traders are unincorporated businesses, the owner can be sued by customers in the event of a dispute.
- Large businesses can employ specialist workers. A sole trader often has to be purchaser, driver, accountant, lawyer and

Advantages of sole traders

Sole traders have a number of advantages.
- The lack of legal restrictions. The sole trader will not face a lengthy setting up period or incur expensive administration costs.
- Sole proprietorships can be set up with little or no money in the business. They don’t cost anything to set up. So the capital cost of creating a sole proprietorship can be minimal.
- Any profit made after tax is kept by the owner.
**Advantages of Partnerships**

- Flexibility: Partnerships allow for more flexibility in decision-making compared to sole proprietorships.
- Economies of Scale: Partnerships can take advantage of economies of scale, which can lead to cost savings.
- Partnership Act: The Partnership Act, 1890 provides legal protection and guidelines for partnerships.
- Limited Liability: Partners can limit their personal liability by creating a partnership agreement.

**Disadvantages of Partnerships**

- Personal Liability: Partners can be personally liable for debts and obligations of the business.
- Lack of Professionalism: Partnerships may lack the professional standards and structures found in larger organizations.
- Legal Complexity: Partnerships can have complex legal and tax implications.
- Difficulties in Dissolution: Dissolving a partnership can be complex and time-consuming.

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**Question 2**

- **Objective:**
  - Explain the reasons why partnerships might be advantageous to an organization.
  - Discuss the limitations of partnerships as compared to other business structures.

- **Context:**
  - Discuss the advantages and disadvantages of partnerships compared to sole proprietorships.
  - Highlight the potential benefits and drawbacks of forming a partnership.

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**Partnerships**

When forming a partnership, it's important to consider the benefits and drawbacks. Partnerships offer the advantage of shared resources and decision-making power. However, they also come with increased administrative overhead and potential conflicts among partners. A well-structured partnership agreement can help mitigate these challenges.

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**Legal Structure — Sole Proprietors and Partnerships**

- **Sole Proprietorships:**
  - Owners have full control over the business.
  - Personal liability.
- **Partnerships:**
  - Shared ownership and management.
  - Limited liability for partners.
  - Potential for increased profits.
Legal structure — sole traders and partnerships

normal for the remaining partners to form a new partnership quickly afterwards.

- Any decision made by one partner on behalf of the company is legally binding on all other partners. For example, if one partner agreed to buy four new company cars for the business, all partners must honour this.
- Partnerships have unincorporated status, so partners can be sued by customers.

Limited partnerships

The Limited Partnerships Act 1907 allows a business to become a LIMITED PARTNERSHIP, although this is rare. This is where some partners provide capital but take no part in the management of the business. Such a partner will have LIMITED LIABILITY - the partner can only lose the original amount of money invested. A partner with limited liability cannot be made to sell personal possessions to meet any other business debts. This type of partner is called a sleeping partner. Even with a limited partnership there must always be at least one partner with unlimited liability. The Act also allows this type of partnership to have more than 20 partners.

The Limited Liability Partnership Act, 2000 allows the setting up of a LIMITED LIABILITY PARTNERSHIP. All partners in this type of partnership have limited liability. To set up as a limited liability partnership, the business has to agree to comply with a number of regulations, such as filing annual reports with the Registrar of Companies.

KEY TERMS

- **Deed of Partnership** — a binding legal document which states the formal rights of partners.
- **Limited liability** — where a business owner is only liable for the original amount of money invested in the business.
- **Limited Liability partnership** — a partnership where all partners have limited liability.
- **Limited partnership** — a partnership where some members contribute capital and enjoy a share of profit, but do not participate in the running of the business. At least one partner must have unlimited liability.
- **Organisation** — a body set up to meet a need.
- **Partnership** — a business organisation which is usually owned by between 2-20 people.
- **Private sector** — businesses that are owned by individuals or groups of individuals.
- **Sole trader or sole proprietor** — a business organisation which has a single owner.
- **Unlimited liability** — where the owner of a business is personally liable for all business debts.

**Knowledge**

1. What is the difference between a corporate body and an unincorporated body?
2. State three advantages and three disadvantages of being a sole trader.
3. What is the advantage of a deed of partnership?
4. State three advantages and three disadvantages of partnerships.
5. What is meant by a sleeping partner?

**Case Study: Oxford Vintage cars**

Hristo Petrow runs a small business buying and selling vintage cars. He buys cars at auctions and from dealers and currently sells them on Ebay. At the moment Hristo does not undertake any renovation work on the cars. He just buys them and sells them on. Last year he made a profit of £37,000. However, Hristo is ambitious and wants to set up his own website and operate from a car showroom in Oxford. A lot of the cars he sells are MGs and MGAs. These cars were originally made in Oxford and Hristo likes the idea of locating a showroom in their home city. He also wants to employ a team of mechanics to renovate them. He knows that premium prices are paid for well restored vintage cars.

Unfortunately Hristo can only raise £50,000 of the £100,000 needed to develop the business. He has approached several banks but has not been able to secure funding as he has a poor credit rating after having his house repossessed. A friend of his, however, is keen to get involved in the business. Mark Watkins bought a car from Hristo three years ago and the two have remained in touch ever since. Mark is happy to provide the other £50,000 if he can become an equal partner.

Hristo has eventually accepted Mark’s offer and the new showroom is due to open very shortly. The partnership, called Oxford Vintage Cars, has a smart website which contains details of all the cars in stock and other useful information for enthusiasts.

After a deed of partnership was drawn up Hristo said ‘At first I did not want to go into partnership, but now I think it will work. Mark is as committed as me and has come up with some good ideas. For example, he reckons we can rent out some of the cars in stock for special occasions such as weddings. I hadn’t even thought of that. He will also be good on the restoration side and he will be able to supervise the mechanics more effectively than me. I will concentrate on the buying and selling, that’s what I’m good at’.

(a) Using this case as an example, explain what is meant by a partnership. (4 marks)

(b) Oxford Vintage Cars is an unincorporated business. What does this mean? (6 marks)

(c) How does this case highlight one of the problems of operating as a sole trader? (6 marks)

(d) Why do you think Hristo did not want to enter a business partnership? (8 marks)

(e) To what extent will the partners be able to specialise in the business? (12 marks)