GAUTENG PROVINCE
EDUCATION
REPUBLIC OF SOUTH AFRICA

# BUSINESS STUDIES

# GRADE 11

# TERM ONE

# CHAPTER FIVE

## BENEFITS OF THE COMPANY OVER OTHER FORMS OF OWNERSHIP



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**This chapter consists of 16 Pages**



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## CONTENT DETAILS FOR TEACHING, LEARNING AND ASSESSMENT PURPOSES

## BENFITS OF A COMPANY OVER OTHR FORMS OF OWNERSHIP

### Learners must be able to:

- Discuss/Explain/Describe the characteristics, advantages and disadvantages of the forms of ownership. (Recap)
- Distinguish/Differentiate/Tabulate the differences between forms of ownership.
- Discuss/Explain the benefits of establishing a company versus other forms of ownership e.g.:
    - Legal status and liability.
    - Profit sharing
    - Ownership and management
    - Capital and cash flow
    - Life span and continuity
    - Taxation
- Discuss/Explain the challenges of establishing a company versus other forms according to the above mentioned benefits.
- Explain/Describe/Discuss the procedure for the formation of companies.
- Discuss/Explain the legal requirements of the name of the company, e.g.:
    - A company is not allowed to use a misleading name,
    - A name reservation is valid for six months, etc.
- Define the following concepts:
    - Memorandum of incorporation
    - Notice of incorporation
    - Prospectus, i.e. initial & secondary offer
- Outline the aspects that must be included in the prospectus.



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## TERMS AND DEFINITIONS

| TERM | DEFINITION |
|---|---|
| Form of ownership | The legal position of the business and the way it is owned. |
| Continuity | Continue to exist even if a change of ownership takes place, e.g. a member or shareholder dies or retires. |
| Securities | Shares and bonds issued by a company. |
| Limited liability | Loses are limited to the amount that the owner invested in the business. |
| Unlimited liability | The owner's personal assets may be seized to pay for the debts of the business. |
| Memorandum of Incorporation (MOI) | The document that sets out the rights, responsibilities and duties of shareholders and directors.(serves as a constitution of a company). |
| Sole Trader /Sole proprietor | A business is owned and controlled by one person who takes all the decisions, responsibility and profits from the business they run. |
| Partnership | An agreement between two or more parties that have agreed to finance and work together in the pursuit of common business goals. |
| Co-operative society | Autonomous association of persons united voluntarily to meet their common economic/ social needs/aspirations through a jointly owned and democratically controlled enterprise. |
| Company | A company is a legal person who has capacity and powers to act on its own. |
| Public company | A public company is a voluntary association of ONE or more persons, governed by the company Act 71 of 2008, incorporated in terms of the Memorandum of Incorporation. |
| Private company | A private company is a voluntary association of 1 or more persons. |
| Personal liability company | A personal liability company is a voluntary association of 1 or more person. |
| State-Owned company | A state-owned company (SOC) is a legal entity that is created by the government in order to participate in commercial activities on its behalf. |
| Partnership Article | A document that contains exhaustive provisions with regards to the matters concerning the business and the partners. |
| Prospectus | Prospectus is a document inviting the public to buy securities/shares. |
| Annual General Meeting (AGM) | A meeting held once a year where the shareholders receive a report stating how well the company has done. |
| Directors | People elected to the board of a company by the shareholders to represent the shareholders' interests. |



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# 1 CHARACTERISTICS, ADVANTAGES AND DISADVANTAGES OF THE FORMS OF OWNERSHIP. (RECAP)

## 1. SOLE TRADE /SOLE PROPRIETOR

### Definition

A sole trader is a business that is owned and managed by one person.

**Characteristics of a sole trader**

- One person can form a sole trader and is easy to start.
- It is inexpensive to start and the owner does not have to pay tax.
- There are no legal and administrative formalities in the formation of a sole trader.
- The profit of the business is belongs to the owner as there is no distinction between the owner and the business.
- A sole proprietor is not a legal entity and agreements are entered into by the owner in his\her personal capacity.
- Business has unlimited liability and the private possessions of the owner can be used to pay the debts of the business

### 2 Advantages and disadvantages of a sole trader

| ADVANTAGES | DISADVANTAGES |
|---|---|
| -Owner makes all decisions. | -Unlimited liability which means the owner is responsible for all debts incurred by the business |
| -Requires little capital to start. | -Cash flow is often a problem. |
| -All profits belong to the owner | -Growth of business can be restricted due to lack of capital. |
| -Simple management structure. | -Not a legal entity and no continuity |
| -Can easily adapt to the needs of the client/customer. | -Difficult to attract highly skilled and knowledgeable employees. |
| -No legal process and requirements. | -The owner is responsible for providing all the capital needed. |
| -The assets of the business belong to the owner. | -If the owner does not have enough knowledge/experience the business may fail. |
| -There is personal encouragement and personal contact between the owner and customers. | |

## 2 PARTNERSHIP

### 2.1 Definition

- A partnership has two or more partners who own the business.
- These owners share the responsibility of the business and they share the financial and management decision of the business.



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## 2.2 Characteristics of a partnership

- An agreement between two or more people who combine labour, capital and resources towards a common goal.
- Partners combine capital and may also borrow capital from financial institutions.
- No legal requirements regarding the name of the business.
- Partners have unlimited liability and are jointly and severally liable for the debts of the business.
- Profit is shared according to the partnership agreement.
- Partnership does not pay tax partners pay personal income tax.
- Auditing of financial statements is optional.
- Partners share responsibilities and they are all involved in decision making.
- No legal formalities to start, only a written partnership agreement is required.
- The partnership does not pay income tax, only the partners in their personal capacities.
- Diversity, specialisation and different skills of the partners can be used.
- Partnership has no legal personality and therefore has no continuity.
- Partners share responsibilities and they are all involved in decision making.

## 2.3 Advantages and disadvantages of partnership

| ADVANTAGES | DISADVANTAGES |
|---|---|
| -The partners able to put their knowledge and skills together to collectively make the best decisions. | -A partnership has unlimited liability so all the partners are liable for the debts if the business becomes insolvent. |
| -The workload and responsibility is shared between partners. | -Each business partner is legally responsible for the joint liability of the partnership. |
| -Partners are able to share resources. | -Different personalities and options of partners can lead to conflict it disagreements. |
| -Partners are only required to pay tax in their personal and individual capacity. | -Partners might not all contribute equally. |
| -The partners have a personal interest in the business. | -Loss in profits and stability of the business can occur if a partner resigns/ dies/loses interest in the business or is declared bankrupt. |
| -Can bring in extra partners at any time. | -There can be lack of capital and cash flow. |
| -Attract prospective employees with the option or incentives of becoming a partner. | |
| -Partnerships are relatively easy to establish. | |
| -Partners contribute new skills and ideas into a business | |
| -Partners share responsibilities for decision making and managing the business | |
| -Partners share any profits and are therefore motivated to work hard. | |
| -Raising additional capital to finance further business expansion is easy as there is no limit on the number of partners. | |
| -Partners are taxed in their own capacities, which could lead to lower taxation. | |



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## 3 CLOSE CORPORATION

### 3.1 Characteristics of a Close Corporation

- Can have a minimum of one and maximum of ten members who share a common goal.
- The word 'close' means that all members are involve and participate in its management.
- Each member makes a contribution of some/assets/services towards the corporation.
- The name must ends with the suffix CC.
- Members have unlimited liability except where the CC has had more ten members for six months or longer.
- A CC has its own legal personality and therefore has unlimited continuity.
- Auditing of books is optional as members only need an accounting officer to check financial records.
- Transfer of a member's interest must be approved by all other members.
- Profits are shared in proportion to the member's interest in the CC.

### 3.2 Advantages and disadvantages of a Close Cooperation

| ADVANTAGES | DISADVANTAGES |
|---|---|
| -There are few legal requirements e.g. auditing of financial statements/regular annual general meetings. | -Limited growth and expansion since a CC cannot have more than ten members. |
| -A CC is a legal entity and has continuity of existence. | -A member of a CC can be held personally liable for the losses of CC if the member acts is incompetent. |
| -Can be converted to a private company and members may become shareholders. | -Audited financial statements may be required when applying for a loan. |
| -Members have limited liability | -A CC is taxed as if it were a company, which may be higher than personal tax rates. |
| -Owners' interest in the CC does not need to be in proportion to their capital contribution. | -Difficult for members to leave the CC as all members must agree to dispose of a member's interest. |
| -CC may be exempted by CIPC from auditing its financial statements. | -A CC is taxed on its income and Standard Tax of Company (STC) based on member's dividends/ Double taxation. |

## 4 Private Company

### 4.1 Definition

It can be a small or large company and has one or more directors.

### 4.2 Characteristics of a private company

- Requires one or more directors and one or more shareholders.
- It needs a minimum of one shareholder and there is no limit on the number of shareholders that a private company may have.



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- Register with the registrar of companies by drawing up Memorandum of Incorporation.
- The company name ends with letters (PTY) Ltd.
- A private company is not allowed to sell shares to the public.
- Investors put capital in to earn profit from shares.
- The company has a legal personality as well as unlimited continuity.
- The auditing of financial statements is optional.
- Profits are shared in the form of dividends in proportion to the share held.
- Shareholders have a limited liability and will not lose their initial capital invested if the business goes bankrupt.
- Shareholders have limited liability and a separate legal entity.
- Raises capital by issuing shares to its shareholders.
- Profits are shared in the form of dividends in proportion to the number of shares held.

### 4.3 Advantages and disadvantages of a private company

| ADVANTAGES | DISADVANTAGES |
|---|---|
| More opportunities to pay less taxation | -Requires a lot of capital |
| -Good long-term growth opportunities | -The more shareholders, the less profits |
| -Own legal identity and shareholders have no direct legal implications/ limited liability. | -More taxation requirements |
| -Board of directors with expertise /experience can be appointed to take decisions | -Directors do not have a personal interest |
| -Not required to file annual financial statements with the commission. | -Annual financial statements must be reviewed by a qualified person, which is an extra expense to the company. |
| -It is a legal person and can sign contracts in its own name. | Difficult and expensive to establish as the company is subjected to many legal requirements |
| -The new Act forces personal liability on directors who knowingly participated in carrying out business in a reckless/fraudulent manner. | -Pays tax on the profits of the business and on declared dividends/Subject to double taxation. |
| -Financial statements are private and not available to the general public. | -Must prepare annual financial statements. |
| -A company has continuity of existence | - |
| -It is possible to sell a private company as it is a legal entity in its own right. | |
| -It can easy raise capital by issuing shares to its members. | |



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# 5 PERSONAL LIABILITY COMPANY

## 5.1 Definition

- Very similar to a private company, the difference is that the directors of a Personal Liability company are jointly and severally liable for all the debts and liabilities of the company. This means that the directors have unlimited liability.
- The name of the personal liability company ends in INC and the name of the private company ends in (PTY) Ltd.

### 5.2 Characteristics of a personal liability company

- The company name must end with letters INC
- Directors have unlimited liability and they are jointly liable for the debts of the business even if they are long out of office.
- The memorandum of Incorporation should state that it is a personal liability company.
- They must at least have one director on their board of directors.

**NOTE: Other characteristics of a personal liability company are the same as the private company except the above mentioned two characteristics.**

### 5.3 Advantages and/or disadvantages

**NOTE:** The advantages of a personal liability company are the same as the private company.

**The disadvantages are also the same as the private company except the directors of the personal liability company have unlimited liability**

# 6 PUBLIC COMPANY

## 6.1 Definition

- A public company is a company that is registered to offer its stock and shares to the general public. This is mostly done through the Johannesburg Securities/Stock Exchange (JSE).
- The public company is designed for a large –scale operation that require large capital investments.

### 6.2 Characteristics of a public company

- A minimum of one person is required to start a public company.
- Requires three or more directors and three or more shareholders.
- Register with the Registrar of Companies by drawing up Memorandum of Incorporation.
- The company name ends with letters Ltd.
- Has legal personality and therefore has unlimited continuity
- Raises capital by issuing shares to the public and borrowing capital by issuing a debenture.
- A prospectus is issued to the public to raise capital.
- Shareholders have a limited liability
- The new Act forces personal liability on directors who knowingly participated in carrying out business in a reckless/fraudulent manner.
- The company has a legal personality as well as unlimited continuity.



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- A public company is required to hold an AGM (Annual General Meeting).
- Auditing of financial statements us compulsory and audited statements are available to shareholders and the public.
- Profits are shared in the form of dividends in proportion to the share held.

### 6.3 Advantages and/or disadvantages

| ADVANTAGES | DISADVANTAGES |
|---|---|
| -The business has its own legal identity | -Must disclose all financial information |
| -Easy to raise funds for growth through the sale of shares. | -Large amount of funds are spent on financial audits. |
| -Shareholder is only liable for the amount which is invested/Shareholders have limited liability. | -Stocks have to be traded publicly. |
| -Can appoint a knowledgeable board of directors. | -A full report must be submitted to the major shareholders each year. |
| -Buy and sell shares freely. | -Difficult and expensive to establish as the company is subjected to many legal requirements |
| -Shareholders can sell/transfer their shares freely. | -The more shareholders, the less profit. |
| -The public has access to the information and this could motivate them to buy shares from a company. | -Shareholders may be allowed little or no input into the affairs of the company. |
| -Additional shares can be raised by issuing more shares or debentures | -Due to legislation, decisions take longer and there may be disagreements. |
| -Strict regulatory requirements protect shareholders. | -Financial affairs must be known to publicly, this information could be used to competitors' advantage. |

## 7 State owned company

### 7.1 Definition

- A state owned company has the government as its major shareholder and falls under the department of Public Enterprise.
- These businesses take on the role of commercial enterprise on behalf of the government.

### 7.2 Characteristics of a State Owned Company

- Requires three or more directors and one or more shareholders.
- Register with the Registrar of Companies by drawing up Memorandum of Incorporation.
- It is owned by the government and operated for profit.
- SOC is listed as a public company.
- The name ends with letters SOC.
- State –owned companies support private businesses by providing infrastructure such as communication service /Post office and supply of electricity/Eskom.



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### 7.3 Advantages and disadvantages

| Advantages | Disadvantages |
|---|---|
| -Profits may be used to finance other state departments | -May result to poor management as government is not always as efficient as the private sector. |
| -Offer essential services which may not be offered by the private sector | -Inefficiency due to the size of the business |
| -Prices are kept reasonable/Create sound competition with the private sector to make services affordable to more citizens. | -Often rely on government subsidies |
| -Wasteful duplication of services is eliminated | -A lack of incentive for employees to perform if there is no absence of other motivator such as productivity bonuses. |
| -Planning can be coordinated through central control. | -Government can lose money through the business. |
| -Generates income to finance social programmes. | -A lack of incentive for employees to perform if there is no share in the profit. |
| -Jobs are created for all skills levels. | -Losses must be met by the tax payer. |
| | -Shares are not freely tradable making it difficult to raise capital. |
| | -SOC must follow strict regulations for operations to raise capital. |
| | -Financial statements must be audited |

### 8 Differences between the private and public company

| PRIVATE COMPANY | PUBLIC COMPANY |
|---|---|
| - May no offer shares to the general public. | - Trades its shares publicly on the Johannesburg Securities Exchange. |
| - Shares are not freely transferable | - Shares are freely transferable. |
| - Minimum of one director. | - Minimum of three directors. |
| - Name must end with Proprietary Limited/(Pty) Ltd. | - Name must end with Limited/Ltd. |
| - Annual financial statements need not be audited and published. | - Annual financial statements need to be audited and published. |
| - Does not need to publish a prospectus as it cannot trade its shares publicly. | - Have to register and publish a prospectus with the Companies and Intellectual Property Commission/CIPC. |
| - The company is not required to raise the minimum subscription/ issue minimum shares. | - Must raise a minimum subscription prior to commencement of the company. |



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## 9 Differences between the private and a personal liability company

| PRIVATE COMPANY | STATE OWNED COMPANY |
|---|---|
| The name ends with (PTY) Ltd | The name ends with INC |
| The directors are not personally liable for the debts of the business. | The directors are personally liable for the debts of the business. |

## 10 Cooperatives

### 10.1 Definition

- A cooperative is a traditional way of a group of interested parties getting together and sharing resources/infrastructures and costs to achieve a better outcome.

### 10.2 Characteristics of cooperatives

- Minimum of five members is required to start a cooperative.
- Register with the Registrar of Companies
- Legal entity and can own land and open bank accounts.
- Members own and run the business together and share equally in its profits.
- Decisions are taken democratically
- They are motivated by service rather than profit
- Must register with the Registrar of Cooperatives Societies
- The word 'Cooperative Limited' must appear at the end of its name.
- They are managed by a minimum of three directors.
- The objective of a co-operative is to create mutual benefit for the members.

### 10.3 Advantages and/or disadvantages of cooperatives

| ADVANTAGES | DISADVANTAGES |
|---|---|
| -Access to resources and funding | -Decisions are often difficult to reach and time consuming. |
| -Decision making is by a group | -Difficult to grow a co-operative. |
| -Each member has an equal share in the business. | -Very few promotion positions for staff. |
| -A co-operative can appoint its own management. | -It can be difficult to get a loan because their main objective is not always to make a profit. |
| -Members have limited liability | -The success of cooperatives depends on the support of the members. |
| -The decisions are democratic and fair | -Shares are not freely transferable |
| -Members are motivated because they are working for themselves | -All members have one vote regardless of the number of shares held. |
| -Can gain extra capital by asking its members to buy shares. | |
| -Co-operatives have continuity of existence | |
| -Resources of many people are pooled together to achieve common objectives | |
| Profits are shared equally amongst members. | |



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## 11 Benefits of establishing a company versus other forms of ownership

### 11.1 Legal status and liability

- A company has its own legal status, trading name and owns its assets.
- Shareholders' private assets are protected as they have limited liability.
- The shareholders have no direct legal responsibility.
- Companies have their own names and these are protected.

### 11.2 Profit sharing

- Shareholders share in the profits of the company through dividends

### 11.2 Ownership and management

- Shareholders are able to buy and sell shares freely in a public company.
- The company is managed by qualified and competent board of directors
- A company is less likely to use consultants as it has a larger pool of skills and expertise
- Directors are more likely to take risks and allow growth opportunities for the business.

### 11.3 Capital and cash flow

- A company may has more investor's to fund the setting up of the business.
- Companies have a better cash flow than sole traders.
- A company is not limited to the individual contribution of the members' capital.
- The long term growth opportunities for companies are really good as there are always possibilities of getting in more investors.
- Directors do not have to take out personal loans to grow the business

### 11.4 Life span and continuity

- A company has continuity of existence.
- Company shares can be transferred/bought/sold.
-

### 11.5 Taxation

- Companies have tax benefits other enterprises do not have
- They may obtain tax rebates if they are involved is social responsibility projects.

## 12 Challenges of establishing a company versus other forms of ownership

- Directors may not have a personal interest in the business and this could prevent the business from gaining maximum growth and profits.
- Directors who do not have a personal interest in the business may not attract investors.
- There may be conflict between the owners of the company and management in control.
- The more shares there are the less profit per share.
- A company is required to submit a full report to all stakeholders each financial year.
- The limited liability aspect of the company generates more paper work in the registration process.
- The owners of the company have more liability.
- When directors change there could be a lack of continuity in management.



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- Companies have more taxation requirements and other taxes are high.
- They are required to disclose all financial information which could provide their competitors with an unfair advantage.
- Politics can get in the way and managers are appointed for the wrong reasons.
- State owned companies often deliver non-profitable services that lead to government losing money through the business.
- A company can stop existing if deregistered by the Registrar of Companies.
- A large amount of money of funds is spent on financial audits and accounting fees due to government regulations.

**13 Procedure for the formation of companies**

- Determine the people establishing the company
- Reserve a company name with the Registrar of Companies
- Prepare a memorandum of incorporation
- File a notice of incorporation
- Obtain a unique registration number
- All companies must be registered with the Registrar of Companies.
- Open a bank account and register for taxation.
- Draw up a prospectus for potential investors.

**14 Legal requirements of the name of the company**

- The name of a company must be original and must not be misleading.
- A company's name must appear on all company documents, e.g. on letterheads.
- Reserving a name for a company is the first step to register a company , but it is not compulsory.
- Names can be reserved for a period of 6 months by the CIPC.
- The name must not be similar/same as any other company unless it is part of the group.
- The name must not imply/suggest/mislead a person to believe that the company is part of another person/business/the state.
- The name must not be offensive/promote violence/hatred and cause any harm.
- The name must not be shortened and translated.
- The name of a company must indicate the type of company as follows: The name of a company must end with.



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## 15 Memorandum of incorporation/MOI

### 15.1 Meaning of memorandum of incorporation/MOI

- MOI serves as the constitution of a company.
- Companies are governed according to the rules stated in the MOI.
- Each company must provide a copy of its MOI to the Companies and Intellectual Property Commission (CIPC).
- MOI describes the relationship between the business and its stakeholders.
- MOI describes the rights, responsibilities and duties of the shareholders and directors.
- Provides details about incorporation, the number of directors and the share capital.
- Includes information about a company's name/registration office and records.

### 15.2 Aspects that must be included in the memorandum of incorporation

- Incorporators
- Nature of the company
- Securities of the company
- Shareholders and meetings
- Directors and officers
- Name of the company
- Main objectives of the company
- Number of shares each incorporator will purchase
- Amount of share capital registered
- Rules and regulations of the company
- Name of the auditor

## 16 Notice of incorporation

- The notice must be lodged together with the Standard Form of Memorandum of Incorporation and it contains the following information
  - Type of company
  - Financial year-end
  - Numbers of directors
  - Incorporation date
  - Registered address
  - Company name

## 17 Prospectus

### 17.1 Meaning of a prospectus

- A prospectus is a written invitation to the public to buy the securities offered by a public company.
- It is a formal legal document giving details about investment offerings to the public.
- A prospectus can only be issued by a company and it must be within three months after the date of its registration.
- It gives information about the business.



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**17.2 Meaning of the Initial order offer/IPO**

- This is when the company issues shares to the public for the first time.
- The company must produce a prospectus before undertaking the initial offering.
- Most companies undertake an IPO with the assistance of an investment banking firm acting in the capacity of an underwriter.

**17.3 Meaning of the secondary offering**

- A secondary offering is an offering of securities by a shareholder of the company as opposed to the company itself, which is a primary offering
- A secondary offering is the sale of new or closely held shares by a company that has already made an initial public offering (IPO)

**17.4 Aspects that must be included in the prospectus**

- Company overview, including the vision, mission and goals of a business
- Product or service portfolio
- Market analysis and strategy
- Management team
- The risk and potential of the business
- Available financial and share information
- Company's assets and liabilities
- Financial position
- Profits and losses
- Cash flow
- Prospects for growth
- Pre-incorporation contracts that have been signed
- Date of registration of the prospectus
- The minimum subscription



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