Unit 2

TYPE AND FORMS OF BUSINESS OWNERSHIP

Unit Outcomes:

After studying this unit, you will be able to:

- list the three common forms of business ownership.
- define each form of ownership.
- explain the advantages and disadvantages of each type of ownership.
- provide a rationale for the choice of ownership.
- make a distinction among the different forms of business ownership.
- identify and explain other alternative forms of business ownership.

Introduction

The world has experienced three economic systems: Free market, Socialist and Mixed economic systems. Free market economy is defined as an *economy in which businesses are allowed to operate without central government planning*. In this type of economy, nearly all businesses and private citizens own properties, either individually or in a group. Private ownership of properties is the basic requirement in a free market economy.

In unit two how a business gets started is explained. The unit also outlines the various legal forms of business ownership. The most common forms of private business ownerships are sole proprietorship, partnership and corporation. Their advantages and disadvantages are discussed. The factors that influence the choice of ownership and the less common forms of business ownership will also be dealt with.

Contents of the unit

In order to achieve the above objectives you will deal with the following topics:

- Common forms of business ownership
- Other forms of ownership
- Choice of ownership form

2.1. Common Forms of Business Ownership

? Identify and group businesses in their forms of business ownership. Then compare your answer with the next paragraphs.

Business can be owned in different forms, each with its advantages and disadvantages. However, the most common forms of business ownership are:

1. ***Sole proprietorship***
2. ***Partnership***
3. ***Corporation***

2.1.1. Sole Proprietorship

Definition: A sole proprietorship is a form of business ownership in which a single individual assumes the risk of operating a business, owns its assets, and controls and uses any profits that are generated. The word sole indicates that the business is started and run by one individual.

As it is defined above, sole proprietorship is a business carried on by an individual acting in an independent way. The business operation will be treated as personal assets and liabilities of the owner. The owner is the ultimate employer and manager of the business.

The concept of sole proprietorship can be illustrated as follows: Let us assume that Ato Alemu Bekele owns and operates a retail grocery known as Alemu grocery: Ato Alemu as a sole proprietor started the grocery by investing Birr 15,000 in cash. He used his personal property, which is estimated to be birr 10,000 for business use. Ato Alemu has also borrowed 4,000 birr from a bank.

Assets		
Cash on hand	15,000	
Personal property	10,000	
Total Assets		25,000
Liabilities		
Loan from bank	4,000	
Total liabilities		4,000
Capital, Alemu Grocery		21,000

This simple financial transaction illustrates that Ato Alemu has started the business with his personal contribution and by borrowing some amount of money from a local bank. Anything of value owned by the business is called ***asset***. In this case, cash on hand and his personal property are assets. Anything of value that is owed is called a ***liability***. The bank loan can be an example of a liability. The 21,000 birr is simply the ***net worth*** or ***capital*** of the business. This shows the financial position of the business when it is started.

Even though Ato Alemu can easily start, operate and close his grocery, he is equally responsible to pay the liability. If the grocery fails to pay its debts and if its assets of the business are not enough to cover the liabilities, Ato Alemu's personal property can be used to meet (pay) his grocery's liabilities.

As we have seen from the above example in sole proprietorship one person assumes all risks and keeps all profits. In a sole proprietorship, the proprietor must accumulate enough capital to start and run a business. The source of capital can be the personal resources of the owner, loans secured by personal credit, or a combination of the two.

Sole proprietorship is also called proprietorship, individual enterprise, sole trader or individual proprietorship. The owner of such kind of business is called a ***proprietor.*** Ato Alemu is a proprietor according to our definition.

Although there are some large proprietorship, commonly proprietorship is the ownership form for small businesses. The owner may hire someone to manage the business, but more often, the owner is also the manger. Actually, the owner manger may find it necessary to make decisions personally rather than delegate them to others.

Activity: 1

- **Define sole proprietorships and name at least five businesses around your locality organized as sole proprietorships.**

Advantages of Sole Proprietorship

Many people start a business by themselves, with the hope of making high profits and others do so because they enjoy being self employed and proprietor.

Sole proprietorship has the following advantages:

a) ***Ease of formation and closing a business:*** It is easy to form a sole proprietorship because the legal formalities and procedures of starting the business are not complicated. Generally, a proprietorship is begun easily as long as the business undertakes a lawful activity for profit. Local governments easily give licenses for sole proprietorship. Individuals with limited resources can start independent business and get themselves self-employed. The cost of starting this type of business is usually very low. Government regulations on sole proprietorship are limited, and therefore, more freedom of action is possible. It is also easy to close-up a sole proprietorship. As long as debts and bills have been paid on the part of the proprietor, a proprietorship can be dissolved as easily as it was begun, merely with a decision to stop operations.

b) ***Complete ownership of all profit:*** The main motive for business activities is profit making. Sole proprietorship is the only form of business ownership in which rewards and efforts go hand in hand. Since the owner of a proprietorship assembles and controls all the assets used to start and run a business, he/she also has the right to all profits that may result from its operations. In other kinds of business organizations, for example in partnerships and corporations, the profits must be shared with others. All of the profits of a sloe proprietorship however, belong to the owner (sole proprietor). This gives a great incentive to the proprietor, to apply the best of his/her ability in running the business. Management skill and hard work are usually the direct causes of profit. The clear relationship between effort and reward is also a strong motivation for most proprietors.

c) ***Freedom of action and flexibility:*** In sole proprietorship all management control is usually in the hands of the sole proprietor. In matters of business dealings, the sole proprietor can take his/her own actions. He/she has no other person to argue with. A proprietorship is easy and flexible to run. Being his/her own master and having the simplest organization, the sole proprietor can change the whole policy of his/her business in a short time to take advantage of opportunities that might arise from different situations.

d) ***High credit standing:*** Banks and other lending institutions are often more willing to give credit to proprietorships than to corporations in which the owners are not personally liable for business debts. When settling the debts of creditors, not only the assets of the business but also the proprietors' personal assets, such as cars, houses, etc may be used. The debts are more likely to be paid because the proprietor's personal assets are available to business creditors. The credit standing of the sole proprietorship may be better than other forms of ownerships. Hence, the proprietor has a great incentive to find ways to satisfy business debts in order to protect his/her own personal assets.

e) ***Tax advantages:*** A sole proprietorship pays small amount of income tax than any other kind of organization. On the other hand, a corporation must pay taxes on its earnings, and then stockholders must pay taxes for the second time when the earnings are distributed to them. But a sole proprietor does not pay individual income tax when he/she uses all or part of the earnings of the sole proprietorship.

f) ***Personal relations with customers and employees:*** The size of the sole proprietorship is usually small. The sole proprietor enjoys the entire profits. Therefore, the proprietor attempts to maintain a close touch with customers and employees. Owner's attention to customers results in increased sales, and direct supervision of employees result in cost reduction.

g) ***Business secrecy:*** In a sole proprietorship, it is easy to maintain business secrets. Any change the proprietor wants to make regarding business methods or policies, he/she can do it without the knowledge of others. If confidential information is a key to the success of the business, it is unlikely that its owner will leak this information to others. Maintaining business secrets is very important in competitive situations.

Disadvantage

Many of the factors that create the advantages of sole proprietorship also result in disadvantages. Before deciding that the sole proprietorship is the best business form to take, the following possible disadvantages should be considered:

a) ***Unlimited liability:*** All assets owned by the sole properties, (both business and personal assets) are subject to claims of business creditors. Despite the effort of the owners, many small businesses may be unable to continue profitably. In a proprietorship all of the asset of the owner, both those invested in the business and personal properties may be sold to settle debts owed to creditors.

b) ***Restrictions on size:*** Since the capital used in sole proprietorship is restricted to what a single person has or can borrow, the substantial amounts of resources needed for a large company are usually not available. In addition, a single manger is not normally capable of running a large business without the assistance of experts in management functions such as planning, organizing, controlling, leading. Because of the limitation on size, particularly because of lack of adequate capital, proprietorships are often unable to compete effectively with corporations or partnerships by hiring personnel with such management skills. The unlimited liability of the owner also restricts the ability of business to undertake large projects because the proprietor may be indifferent to risk losing both his/her business and personal assets.

c) ***Limited Life:*** Since a sole proprietorship exists through the efforts of a single person, the firm often is forced to shut down or discontinue its operations if the owner dies or becomes disabled. The assets of a proprietorship may often be sold to a new investor in case the owner dies. But the highly personalized relationship between the former owner and customers makes it difficult, in many cases, for a new owner to continue the business successfully.

Activity: 2

- **List the advantage and disadvantages of sole proprietorship.**
- **Give examples for each advantages and disadvantages of sole proprietorship based on businesses practices around your locality.**

2.1.2. Partnership

Definition: **A partnership is an association of two or more persons to carry on as co-owners of a business for profit.**

In partnerships, partners contribute their private capital, whether owned or borrowed, accept personal liability for all the debts of the business, and share the profits among themselves in some manner that is satisfactory to all involved. The contribution and share of the profits of each partner need not be equal.

Any kind of business can be operated as partnership: A super market, a restaurant a small manufacturing organization, groceries are examples. But partnerships are particularly common among businesses that provide professional services. Medical doctors, dentists, lawyers, accountants and other professional often use this form of ownership to take advantages of each other's expertise in various areas, and to contribute additional capital for their business.

From the example given above we can understand that in a partnership two or more persons join their assets, skills and other resources assuming all risks and sharing in profit or loss. Each of the owners of such form of business is called ***partners.*** Partner's relationship is based on agreement, written or oral, that is both voluntary and legal called ***article of co-partnership***.

The articles of partnership shall be drawn up by the partners and contains the items that follow.

1. Date of contract and length of life of the agreement;
2. The name, address, and nationality of each partner;
3. Nature of business, location and name of firm;
4. The contribution of each partner, the method of contribution and value of contribution;
5. Distribution of profits and losses;
6. Duties of each partner and hours of personal services;
7. Limitation on withdrawal of funds from the business;
8. Provision for a fiscal year;
9. Method to be followed in case of withdrawal of a partner and liquidation of the partnership
10. Method to be followed to admit a new partner to partnership.

The articles of partnership of "Belay and Tilahun Super Market" are illustrated below:

Belay and Rahma Super Market Articles of Partnership

THIS CONTRACT, made and entered into on the 7th day of July (Hamle), year 2005/1997 by and between:

1. Ato Belay Bekele (Ethiopian; address: Addis Ababa, Wereda 10, Kebele 13, House No. ***)
2. W/ro Rahma Awol (Ethiopian; address: Addis Ababa, Wereda 3, Kebele 47, House No ***)

Witnesseth: That the said parties have this day formed partnership for the purpose of engaging in and conducting a super market business in the city of Addis Ababa under the following stipulations, which are part of this contract:

First: The said partnership is to continue for an indefinite period of time.

Second: The Business is to be conducted under the firm name of "Belay and Rahma Super Market" at Addis Ababa, Wereda 10, Kebele 11, House N0. ***

Third: The investments are as follows:

Ato Belay Bekele: Birr 23,000.00 after deducting a debt of Birr 4000 from the following assets:

- Cash	Birr	8,000.00
- Merchandise		14,000.00
- Furniture		5,000.00

W/ro Rahma Awol: Birr 23,000.00 after deducting a debt of Birr 3,000.00 from the following assets:

- Cash	Birr	13,000.00
- Merchandise		8,000.00
- Equipment		3,000.00
- Furniture		2,000.00

Fourth: Each partner is to devote his entire time and attention to the business and to engage in no other business enterprise without the written consent of the other partner.

Fifth: During the operation of this partnership, both partners have to serve as co-managers and make business decisions mutually.

Sixth: At the end of each annual fiscal period, the net income or the net loss of the partnership is to be shared equally.

Seventh: Neither partner is to withdraw assets in excess of birr 1,000.00 a month, any part of the assets invested, or assets in anticipation of net income to be earned, without the written consent of the other partner.

Eighth: In case of the death or the legal disability of either partner, the other partner is to continue the operations of the business until the close of the annual fiscal period on the following June 30. At the time, the continuing partner is to be given an option to buy the interest of the deceased or incapacitated partner at not more than 15% above the value of the deceased or incapacitated partner's proprietary interest as shown by the balance of his proprietorship account after the books are closed on June 30. It is agreed that this purchase price is to be paid one half in cash and the balance in four equal installments payable quarterly.

Ninth: An additional person may be admitted to the partnership only with the consent of both partners. All partners, including the newly admitted partner should sign a new contract.

Tenth: Upon liquidation of the partnership, for any reason, the assets of the partnership after the liabilities are paid, are to be divided in proportion to the balance of each partner's proprietorship account balance on that date.

In witness where of, the parties aforesaid have signed and affixed their seales on the day and year above written

Belay Bekele (seal) _ _ _ _ _ _ _ _ _
Rahma Awol ((seal) _ _ _ _ _ _ _ _ _ _

2.1.2.1 General Partnership

General partnership is an agreement between two or more persons who are eligible for entering into binding contracts. The partners contribute their private capital either owned or borrowed. These same partners are liable for all the debts of the business personally, jointly and severally. Profits are shared among partners in a manner that is satisfactory to all involved in the partnership. The contribution and share of the profits of each partner need not be equal.

In a general partnership, all partners have unlimited liability. In general partnership the partners individually and as a group, are equally liable for the business's debts, even if the partners must use their personal assets to satisfy them.

Advantages

The advantages of a general partnership are:

a) ***Ease of starting the business:*** Partnerships are not more difficult to establish than sole proprietorships. At most they require a written contract, called "articles of partnership" between the partners.

b) ***Good credit standing:*** The credit standing for a partnership generally is even better than a sole proprietorship, since all the personal and business assets of the partners may be liquidated to settle business debts.

c) ***Tax saving:*** Partnerships are taxed only as an organization. Individual incomes of partners from profit sharing of the partnerships are not taxed separately.

d) ***Large amount of capital:*** Although most partnerships have few members, multiple ownership still provides considerably expanded financial resources when compared to a sole proprietorship. The personal wealth and credit of all the partners may be pooled to provide the capital need of a large operation or for a firmer financial base for a small business. The formation of a partnership often means less risk for each individual partner.

e) ***Diversity of management skills:*** Partnerships can provide wider range of business and management skills than sole proprietorships. Partners often have complementary abilities: One may be skilled in sales and marketing, another in financial management, another in production or services. This diversity can lead to a sounder business operation.

f) ***Opportunities for growth are better:*** More capital and management skill allows partnerships to grow more easily than most sole proprietorships. Expansion or the development of new products or services requires capital. Partners generally have more combined assets than a single individual. The diverse management skills available to partnerships permit a wider range and larger scale of business operations. The specialized employees that would be needed for a larger firm can often be attracted and kept in the organization by including them in the partnership agreement.

Disadvantages

Some of the disadvantages of partnerships are similar to those of a sole proprietorship:

a) ***Limited duration:*** If one of the partners dies or becomes unable to continue in the business, the partnership must be dissolved or changed in some way. Such uncertainty about the duration of a partnership may interfere with making long-term commitments.

b) ***Unlimited liability:*** The unlimited liability of each partner for the debts of the business is probably one of the disadvantages of this form of ownership. This can result in severe losses to one or more partners when the assets of other partners are not sufficient to pay their share of the debts.

c) ***Restricted growth potential:*** Even though a partnership has a greater capacity for growth than a sole proprietorship, it is also quite limited in the capital it can raise and the staff it can assemble compared to a corporation due to the following reasons: **i) Management conflict** and **ii) Difficulty of recovering investments.**

i. ***Management conflict:*** In a partnership, especially in small business, all partners often have equal authority. This division of authority can result in conflict when two or more of the partners disagree. These conflicts can become very severe and may result in the discontinuation of the business.

ii. ***Difficulty of recovering investments:*** Once an individual's resources are invested in a partnership, it is often difficult to recover the assets of the person who decides to withdraw, and it may be hard to find another buyer with the right combination of capital and skills. If a partnership is forced to dissolve because of the wish of a partner to do so, assets often must be sold below market value and loss results for everyone.

Activity: 3

1. **Identify the nature of general partnership.**
2. **What is "articles of a partnership"?**
3. **What are the advantages of partnership?**
4. **List the disadvantages of partnership.**

2.1.3 Corporation

A business may need more capital than could be provided by a sole proprietor or by two or more partners. Under these circumstances a third form of business organization called corporation may be used.

Ato Sultan and Ato Zeberga have a plan of organizing a big department store, like Tana Department Store. But they are unable to cope up with the capital, managerial skills and other resources needed of the intended organization.

Definition: A corporation is an association of individuals created under authority of law, which exists and has powers and liabilities independent of its members.

Ato Sultan and Ato Zeberga, together with three other investors, want to incorporate a department store.

Ato Sultan and Ato Zeberga with the other three investors (W/ro Chaltu Gemeda, Ato W/Mariam Kebede and W/t Gennet Teshome) took the responsibility of the initial organization of the corporation and provided the initial assets for the corporation. Persons who are responsible for the initial organization of a corporation and who provide the initial assets for a corporation are called **incorporates or promoters**.

The incorporates apply to the proper government agency (Ministry of Trade) requesting permission to form the corporation.

The articles of incorporation are illustrated with example shown below:
Edget Department Stores Corporation
Articles of Incorporation

First: The name of the corporation is Edget Department Stores Corporation

Second: The principal office of said corporation is located at Addis Ababa, Wereda 3 Keble 5, House Nº ***.

Third: The nature of the business, or objects, or purposes to be transacted, promoted, or carried on, is to engage in the business of selling different consumer goods and all business incidental to such sale.

Fourth: The total number of shares of stock that corporation shall have authority to issue is Ten Thousand (10,000) and the par value of each of such shares is five hundred birr (birr 500), amounting in the aggregate to five million birr (birr 5,000,000).

Fifth: The amount of capital with which the corporation will begin business is one million birr (birr 1,000,000).

Sixth: The names and places of residence of the incorporates are follows:

Ato Sultan Ali -- Addis Ababa, W 10, K 13, H. No ***
W/ro Chaltu Gemeda-- Addis Ababa, W 10, K 13, H. No ***
Ato Zeberga Dessu-- Addis Ababa, W 2 K 2, H. No. ***
W/t Gennet Teshome-- Addis Ababa, W 3, K 47, H. No ***
Ato W/Mariam Kebede--Addis Ababa, W 3, K 15, H. No ***

Seventh: The Corporation has to have perpetual existence

We, The Undersigned, being each of the incorporates here in before named for the purpose of forming a corporation to do business both within and without the city of Addis Ababa, according to Commercial code of Ethiopia and other related codes, do make this certificate, hereby declaring and certifying that facts herein stated are true and accordingly have signed and affixed seals this fifth day of March 10, year 2001.

In the presence of: ________________ (seal)
________________ ________________ (seal)
________________ ________________ (seal)
Ministry of Trade ________________ (seal)

GIVEN under my hand and seal of office the day and year aforesaid

____
Authorized person

The predominant form of ownership for a large business is corporation. A corporation may be created for many purposes: Charitable, educational, governmental, and so forth. A business corporation, however, is organized for the purpose of providing goods and services for a profit.

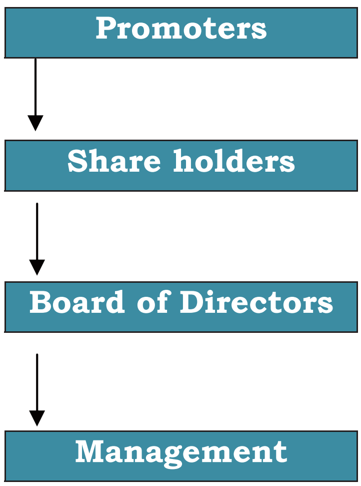
A corporation is made up of and is owned by a group of people called **share** or **stockholders**. The ownership of a corporation is divided into transferable unit called share or stock. According to Ethiopian Investment Authority the establishment of corporation requires at least five persons and there is no maximum as to the number of share or stockholders. The owners share in the total investment and divide any profits that are made. The part of the profit that each share holder received is known as dividend. A corporation is created under the authority of law, and a charter must be obtained from federal or a state government before a business corporation can be formed. A corporation exists separate from its owners as legal entity. As such, it has certain rights granted by law. It may own and sell property, borrow money, manage its own affairs, enter into contracts and sue in court. Corporation is liable for the payment of its own debts. Individual owners are liable to the extent that they have invested money in the corporation, owners, thus have limited liability.

A corporation can be either a private limited or public limited depending upon its characteristics. The distinguishing feature of a private share company will have a limited number of share holders generally restricted to the members of the family. On the other hand a public limited company will have a large number of shareholders from different classes of the society.

Generally a share company may issue different types of shares with an intention to enlarge its capital. If a corporation issues only common stock, each share generally has equal rights. In order to appeal to a broader investment market, a corporation may provide for one or more classes of stock with various preferential rights. The preference usually relates to the right to share in distributions of earnings. Such stock is generally called preferred stock.

How is a corporation managed?

One way a corporation differs from both individual proprietorships and partnerships is in its management. The owners of individual proprietorships and partnerships usually manage their own enterprises. But in a corporation every stockholder is a part owner, and one corporation may have hundreds or thousands of stocks or shareholders. The shareholders' general meeting is the supreme managing body of the corporation. Each shareholder is allowed as many votes as he/she owns shares of stock. For example if one investor has 20 shares it means the investor has twenty votes. The shareholders' general meeting elects **the board of directors**. Board of directors manages the corporation. The general manager elected by board of directors governs the operation of the corporation or the day to day activity of the corporation. The Board of directors also decides how the profits shall be used. Corporations divide surplus profits among stockholders by paying dividends on shares of stock.



- **Promoters** are those people who took the responsibility of the initial organization of the corporation and provided the initial assets for the corporation.
- **Share holders** are group of people who own the corporation.
- **Board of Directors** are elected by the general meeting of the share holders and are responsible to govern the operation of the corporation.
- **The management** is responsible to govern the day to day activity of the corporation.

Figure. 2.1 How a corporation is formed and managed

Advantages

Many advantages of the corporation arise from its multiple ownership and its existence separate from its owners. The main advantages are:

a) the ability to raise large amounts of capital
b) limited liability of the investors
c) continuous existence
d) ease of investing and withdrawing investment
e) specialized management

A corporation has the capability of raising the tremendous amounts of capital needed for large manufacturing, transportation, finance, construction, etc. enterprises. Corporations can accumulate capital by selling shares (stocks). Assets of large corporations amount to hundred millions of birr; neither the proprietorship nor partnership has been able to raise such amount of money. The limited liability offered by the corporate organization attracts large numbers of investors than sole proprietorship or partnership can attract. If a person invests birr 10,000 in a corporation's stock, he or she would lose only that 10,000 birr. If the corporation is dissolved, personal assets other than the amount invested are not risked.

Another feature of the corporation that has made it the predominant kind of ownership of a large firm is its ability to survive independent of any particular investors or mangers. Even if the owner of a significant number of stock holders die or wish to withdraw, his or her portion of ownership can usually be easily sold on the market, and the business activities of the corporation continue for long periods of time. The fact that portions of ownership in the form of stock can be traded in the open market like any other commodity is an advantage in itself. This makes it easy for investors to acquire partial ownership and withdraw from the corporation when they wish.

Corporations can provide the company with adequate and diverse management. The company is free to hire any employee. It can afford to pay good salary and wages and is thus able to get specialized professional skills needed for sound management

Disadvantages

The main disadvantages of corporations are:

a) generally high taxation
b) the complexity and high cost of its establishment and operation
c) legal restrictions on activities
d) relatively lower credit standing

Other less important disadvantages are:

i. Mangers of corporation do not have strong personal motivation that results from personal ownership and liability
ii. For companies with many stockholders, confidentiality of financial information becomes practically impossible to maintain. Of the greatest disadvantage of this form of ownership is that corporations are taxed more heavily than sole proprietorship or partnership. A corporation is separate legal entity; its earnings are taxed directly and at a relatively high rate. The same earnings are taxed again as personal income when they are distributed to stockholders.

The role of governments in authorizing the operations of corporations creates still other disadvantages: corporations are often expensive to establish and complex to run because of government regulations. Incorporation fees must be paid when the charter is secured. More government regulations apply to corporations than to any other form of ownership. Keeping record of the company's stock and its owner is another job that is not necessary in a sole proprietorship or partnership.

When the charter is granted for a new corporation, the kinds of business activities to be undertaken are specified. If the corporation wishes to engage in other activities, an amendment to the charter is required. Although this process is usually routine. It costs money in terms of management time and legal fees. The resulting delay sometimes interferes with the chance to take advantage of opportunities that might arise.

The limited liability of investors lowers the credit standing of the company. Lending institutions know that owners cannot be required to use their personal assets to settle the corporation's debts. If a sole proprietorship and a corporation of the same size apply for a bank loan the proprietorship would have a slight advantage over the corporation because of unlimited liability of the owner.

Activity: 4

1. **Who are incorporates?**
2. **Define articles of incorporation**
3. **Explain limited liability**
4. **What are the sources of many of the advantages of a corporation?**
5. **List the main advantages and disadvantages of a corporation.**

Advantages and Disadvantages of the three forms of business ownership

Advantages

Sole proprietorship	Partnership	Corporation
a) Ease of setting up, operating, and closing	a) Relatively easy to set up	a) Limited liability of investors.
b) Complete ownership of profits	b) Partners own the profit	b) Ease of investing and withdrawing investment.
c) Higher credit standing	c) Even higher credit standing than sole proprietorship	c) Ability to raise larger amounts of capital
d) Lower tax rate.	d) More capital is available than sole proprietorship	d) Survival almost assured
	e) Great diversity of operating skills	e) Specialized management
	f) Better prospects for growth	

Disadvantages

a) Unlimited liability for the owner b) Restricted growth potential c) Sickness or death of owner may mean end of business	a) Unlimited liability for the partners b) Restricted growth potential c) Sickness or death of partner my mean end of business d) Potential conflicts between partners	a) Generally higher taxation b) Complexity in starting up and in operating c) Legal restrictions on activities d) Lack of motivation toward company goals among its hired managers e) Loss of financial confidentiality in corporations that offer their securities to the general public

2.2. Other Forms of Business Owner Ships

While the main forms of business ownerships are sole proprietorship, general partnership, and corporation, there are numerous variations that may be used in certain instances. These variations are

1. Limited partnership
2. joint venture
3. joint stock company
4. cooperative
5. franchise
6. Licensing

Each form has advantages under certain circumstance.

2.2.1 Limited Partnership

Definition: Limited partnership is a form of business ownership in which one or more partners are granted limited liability, with at least one partner with unlimited liability.

The law makes it possible to establish a partnership in which one or more partners are granted limited liability, provided that there is always at least one partner with unlimited liability. This form of ownership is limited partnership. The partner or partners with limited liability are protected against losing more than the amount they have invested in the business because their personal assets cannot be seized for the settlement of the debts of the business. They are not, however, allowed to take an active part in managing the business. The main advantage of this type of ownership is that it allows the partnership to acquire capital from investors who do not wish to be active in the business.

2.2.2. Joint Venture

Definition: A contractual agreement joining together two or more parties for the purpose of executing a particular business undertaking. All parties agree to share in profits and losses of the enterprise.

A Joint Venture is different from ordinary general partnership in that it is formed for a particular purpose or venture. A partnership generally involves an ongoing, long term business relationship, whereas a joint venture is based on a single business transaction. This form of ownership is often used in real estate transactions and is sometimes the initial form of new corporations taken when they are first being set up. For example, if the partners, Ato Kebede and W/o Elsa, owners of a super market agree to operate their business for 5 years, 10 years, etc instead of for an indefinite period of time the partnership can be called joint venture.

2.2.3. Joint Stock Company

Definition: Joint stock company is a partnership that is established by raising capital by selling portion of its ownership on the open market in the form of stock certificates.

Partnerships may be established by raising capital through the sale of portions of ownership on open market in the form of stock certificate. Such organization is called a joint stock company. It combines features of a partnership and a corporation. Although this form of ownership is legal, it is seldom used today because stockholders have unlimited liability when it comes to the financial obligations of the company.

2.2.4 Cooperative

Definition: Cooperative is a group of small producers of goods or consumers of goods and services that wish to band together to achieve competitive advantage of large size in the market.

Small producers of goods or consumers of goods and services sometimes wish to band together to achieve the competitive advantage of large size market place. Such groups may form a cooperative in which production, marketing, or purchasing facilities are jointly owned and are operated mainly to provide a service to members, rather than to make a profit. Farmers, tailors, and other producers may form marketing cooperatives. Consumer cooperatives attempt to achieve lower prices by buying in quantity and by eliminating the profit in the final selling of goods. In a cooperative, any profit made is usually distributed to members as a rebate (refund of part of the original investment). Members of a cooperative usually have one equal vote in running its affairs, no matter what share of ownership they have.

? **Identify the cooperatives that you are familiarized within your locality.**

2.2.5. Franchise

Definition: **Franchise is a licensing arrangement that permits an individual to own his or her business while benefiting from the use of the trademark, know-how, and reputation of an established firm.**

The individual owner of the business who uses the trademark, know-how, and reputation of established firm is called the **franchisee**. The parent company allowing the franchisee to use its trademark, know-how and reputation is called **franchiser**. The franchisee pays the parent company (the franchiser) a royalty from part of the business's profit.

The franchise offers persons who are relatively inexperienced in a particular field, a chance to own and operate a business. In effect, it is a form of sole proprietorship. The franchiser provides the franchisee with a facility, operating advice, and marketing support. In return, the franchisee can be expected to make an initial cash outlay of an agreed upon amount. A good example of franchise in Ethiopia is Oil companies and filling stations throughout the country. For example, Total Ethiopia Ltd. (franchiser) allows large number Total filling stations (franchisees) to use its trade mark, know-how and reputation in their retail filling station business.

? **List the different types of franchising business that are acquainted with in your locality.**

2.2.6 Licensing

License may be granted by a party ("licensor") as an element of an agreement between those parties. A license is "an authorization (by the licensor) to use the licensed material (by the licensee). A licensing agreement is a written contract under which the owner of a copyright, know how, patent, service mark, trademark, or other intellectual property, allows a licensee to use, make or sell copies of the original. Such agreements usually limit the scope of field of the licenses and specify whether the licensee will pay royalties or some other consideration in exchange. While licensing agreements are mainly used in commercialization or a technology, they also used by franchiser to promote sales of goods and services.

Activity: 5

1. **List the three factors that influence the choice of business ownership form.**
2. **What are other forms of business ownerships?**
3. **Make a distinction between general partnership and limited partnership.**
4. **Explain the difference between joint venture and joint stock company.**
5. **Give examples of cooperatives from your locality.**

2.3. Choice of Ownership Form

There are three factors that influence choice of ownership form. Each of the three kinds of ownership has important advantages and disadvantages, and no form is ideal for all businesses. The special characteristic of each form however, usually makes one form more suitable than another for a given business enterprise. Fortunately, the form of ownership can usually be changed as needed.

The major factors to be considered in choosing a form of ownership are:

1. The nature of business
2. The financial effect on operations
3. The attitude of the owners

2.3.1. Nature of the Business

The size of the business and the kind of goods and services it provides will influence the form of ownership. The features of sole proprietorship are generally best suited to small businesses, while one of the main advantages of corporation is that it can provide the resources and management needed for a large company. Sole proprietorships are more common in business with local markets, while corporations are suited to regional or nationwide operations. If the form of ownership chosen is corporation, the business will always be subject to more government regulations than proprietorships or partnerships.

2.3.2. Financial Effects of Operations

The amount of funds needed by a business is one of the most important factors in choosing a form of ownership. A sole proprietorship is limited to the resources of the owners and partnerships are limited to the resources of its partners. Corporations however, can assemble large amounts of capital from many different investors. The degree of risk and the extent of liability that the owners are willing to accept will affect the choice of form of ownership. A corporation usually has less tax advantage. The division of profits is usually quite simple in a corporation since earnings are distributed based on the number of shares owned. Some partnerships require complex earning distribution schemes to allow for the varying contributions and portions of ownership held by partners.

2.3.3. Attitudes of Owners

The number of owners involved in a business venture has an obvious effect on the form of ownership. Often, an entrepreneur may wish to have complete control of operations and may be unwilling to share profits. Where there are multiple owners, other factors must be considered. If continuing operations are to be established, one that will outlast its founders, a corporation is the most suitable. If the owners wish to retain a high degree of direct control over the operations of the business, a partnership will more often offer this than would a corporation. A partnership also generally gives owners more equal participation in management. Corporate organization typically limits the authority of individuals to specific areas.

? **Discuss the three common form of business ownership in relation to the factors to be considered in choosing the ownership form.**

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Summary

- Most of the business facilities and resources are privately owned in free market economy. The ownership may take a number of legal forms. The most common forms of business ownership are:
  a) sole proprietorship
  b) general partnership
  c) corporations
- In a proprietorship, assets and profits are owned by one individual who has unlimited liability for the legal and financial obligations of the business.

  In a general partnership, assets and profits are owned by two or more persons who has unlimited liability for business debts

  Stockholders own the assets and share the profits of a corporation. Their risk and liability are limited to the amount of their investment.

  The three common forms of business ownership have their own advantages and disadvantages.
- The choice of the best type of ownership for a business is based on:
  a) nature of the business
  b) the financial effects on operations
  c) the attitudes of owners
- In addition to the three common forms of ownership, there are six alternative forms which can provide special solutions for business problems and needs. These alternatives forms include: Limited partnership, joint venture, joint stock company, cooperative, Franchise and Licensing.

Review questions

Part I. Choose the best answer from the given alternatives.

1. What is the term that describes anything of value owned by the business?
   a) Assets c) Capital
   b) Liabilities d) Ownership

2. A group of people that ask a corporation is called ______________.
   a) Share holders c) Incorpaters
   b) Stock holders d) a and b

3. What is a partnership that is established by raising capital by selling portion of its ownership in the open market?
   a) Cooperative force c) Join stock company
   b) Limited partnership d) Joint venture

4. Which group are responsible for running of enterprise?
   a) Promoters c) In capitals
   b) Shareholders d) Board of directors

5. What is the term that describes refund as part of the original investment?
   a) Franchise c) Fund
   b) Rebate d. Profit

Part II. Answer the following questions briefly.

1. List the most common types of business ownerships.
2. What are the three major factors that influence choice of business ownership?
3. What are the three major alternative forms of business ownership?
4. Define the following terms:
   a) Sole proprietorship b) Partnerships c) Corporation
5. What are the advantages of sole proprietorship?
6. What are the disadvantages of partnerships?
7. List the main disadvantages of corporation
8. What is the difference between unlimited and limited liability?
   a) Which of the three main forms of ownerships have limited liability?
   b) Which have unlimited liability?
9. In what ways are partnerships advantageous over proprietorship?
10. How is a limited partnership differ from a general partnership?
11. How is a joint venture differ from a general partnership?

12. Why do small producers sometimes form cooperatives?
13. Define franchise and give example of companies in your locality

Part III. Case Study

Ato Ayalew Zewdu and W/ro Tsige Getachew dreamed opening a restaurant. Just a little place, a dozen of tables etc, but with great food décor. Ato Ayalew and W/ro Tsige actually did open their small restaurant in the town of Awassa after three months of hard work.

Setting up a restaurant is an expensive undertaking. As investor they had spent birr 70,000, most of it borrowed. Rent in Awassa is high, a kitchen had to be built and restaurant appliances and fixtures are costly. Table and chairs, dishes and ashtrays had to be purchased. Menus had to be printed. Foodstuff, soft drinks and liquor had to be purchased.

Given these difficulties, it is fortunate that Ato Ayalew and W/ro Tsige had some restaurant experience before they launched their venture. Ato Ayalew had worked in three different restaurants as a waiter and W/ro Tsige had worked in several restaurants as a restaurant manager.

Based on the information given above answer the following questions

1. What are the advantages of running a restaurant choosing partnership as a form of ownership? The disadvantages?
2. Do you think starting the restaurant would have been easier if there had been more partners? Why or why not?
3. How might Ato Ayalew and W/ro Tsige resolve disagreements so as to preserve their partnership?
4. If Ato Ayalew and W/ro Tsige wanted to form a corporation (restaurant) would you advise them to do so? Explain your answer.