

Forms of Business Ownership and Legal Implications

4.1 Consideration for the choice of the form of Business organization. You have to appreciate the fact that there are various forms of business organizations that exist in the environment. Again, business is a profit-seeking enterprise established for the purpose of creating goods and services that meet the needs of mankind. Business plays a major role in the lives of every individual as well as a nation (Oluwafemi, 2000). Business activities are undertaken to improve the financial and the material welfare of the participants. A major group that plays an active role in business within a capitalist economy is the entrepreneur, that is, a person who perceives investment opportunities and takes advantages to exploit them by organizing for the business (Lawal, 1993).

Selecting a form of business ownership is a landmark step in the creation of a venture. Most entrepreneurs however are not trained in the finer points of business law. Consequently, it is imperative that an entrepreneur carefully searches for the types of legal ownership and then consults an attorney (lawyer), and an accountant or both to verify whether the choice addresses their specific needs (Scarborough Wilsion and Zimmerer, 2009). One of the main reasons small businesses fail is that they do not seek legal and accounting help at the beginning. Nickels, Mchugh and Mchugh (2005) stated that one of the key to success in starting a new business is to understand how to get the resources you need. To stay in business, an entrepreneur may need help from someone with more expertise than he/she has in certain areas, or may help to raise more money to expand. How you form your business can make tremendous difference in your long-term success as an entrepreneur. Although an entrepreneur may change the form of ownership later, this change can be expensive, time consuming, and complicated.

There is no single best form of business ownership. Each form has its own unique set of advantages and disadvantages. The key to choosing the optimum form of ownership is the ability to understand the characteristics of each business entity and how they affect an entrepreneur's business and personal circumstances. The following, according to Scarborough et al (2009), are relevant issues the entrepreneur should consider in the evaluation process:

Tax consideration: In a graduated tax rates, the government's (that is Local, State and Federal) constant modification of the tax code, and the year-to-year fluctuations in a company's income require an entrepreneur to calculate the firm's tax liability under each ownership option every year.

Liability exposure: Certain forms of ownership offer business owners greater protection from personal liability due to financial problems, faulty products, and a loss of other difficulties. An entrepreneur must evaluate the potential for legal and financial liabilities and decide the extent to which they are willing to assume personal responsibility for their companies' obligations.

Start-up and future capital requirements: The form of ownership can affect an entrepreneur's ability to raise start-up capital. Also as a business grows, capital requirements increase, and some forms of ownership make it easier to attract outside financing.

Management ability: Entrepreneurs must assess their own ability to successfully manage their own companies. Otherwise, they may need to select a form of ownership that allows them to involve people who possess those needed skills or experience in the company.

Business goals: The projected size and profitability of a business influences the form of ownership chosen. Business often evolves into a different form of ownership as they grow, but moving from some formats can be complex and expensive. Legislation may change and make current ownership options less attractive.

Management succession plans: Entrepreneurs, in selecting a form of business ownership, must look ahead to the day when they will pass their companies on to the next generation or to a buyer. Some forms of business ownership better facilitate this transition. In other cases, when the owner dies –so does the business.

Cost of formation: The cost of formation to create business ownership varies from one form to the other. Entrepreneurs must weigh the benefits and the costs of the form they choose.

4.2 Forms of Business Ownership Whether small or large, every business fits one of three categories of legal ownership, sole proprietorships, partnership, and corporations (Brone and Kurtx, 2009).

4.2.1 Sole Proprietorship The sole proprietorship is the simplest and most popular form of ownership. This form of business ownership is designed for a business owned and managed by one individual. Sole proprietorship is the easiest kind of business for you to explore in your quest for an interesting career. The sole proprietor is the only owner and ultimate decision maker for the business. The sole proprietorship has no legal distinction between the sole proprietor status as an individual and his or her status as a business owner. The simplicity and ease of formation makes the sole proprietorship the most popular form of ownership in Nigeria. One approach when naming a business is to visualize the company's target customer. What are they like? What are their ages, gender, lifestyles and location? What makes our company competitive or unique to those customers? Although sole proprietorships are common in a variety of industries, they are concentrated primarily among small businesses unit such as repair shops, small retail outlets, and service providers, for example, such as painters, plumbers, and barbing saloon.

Advantages of proprietorship: Following are the advantages of proprietorship 1) Least cost of business ownership to establish 2) Minimum or no special legal restriction 3) Ownership of all profit 4) No special taxes since business income and proprietors' income are taxed as one. 5) Maximum incentive to succeed 6) Privacy 7) Flexibility of operation 8) Easy to discontinue

Disadvantages of proprietorship: Following are the disadvantages of proprietorship
1) Unlimited personal liability 2) Limited access to capital for expansion 3) Limited skills and abilities 4) Feelings of isolation /overwhelming time commitment 5) Few fringe benefits 6) Limited growth 7) Lack of continuity for the business that has a limited life span.

4.2.2 Partnership Another option for organizing a business is to form a partnership. A partnership is a legal form of business with two or more owners. Partners legally share a business assets, liabilities, and profits according to the terms of a partnership agreement. The law does not require a written partnership agreement, also known as the articles of partnership, but it is wise to work with an attorney to develop an agreement that documents the status, rights and responsibilities of each partner. The partnership agreement is a document that states all of the terms of operating the partnership for the protection of each partner involved. Banks often want to review the partnership agreement before lending the business money. A partnership agreement can include any legal terms the partner's desire. The standard partnership agreement will likely include the following information: 1) Name of the partnership 2) Purpose of the business 3) Location of the business

4) Duration of the partnership 5) Names of the partners and their legal addresses 6) Contributions of each partner to the business, at the creation of the partnership and later. 7) Agreement on how the profits or losses will be distributed. 8) Agreement on salaries or drawing rights against people for each partner. 9) Procedure for expansion through the addition of new partners. 10) Distribution of the partnership asset to the partners. (11) Sale of the partnership interest 12) Absence or disability of one of the partners 13) Voting rights 14) Decision making authority 15) Financial authority 16) Handling tax matters 17) Alteration or modifications of the partnership agreement. 18) Termination of partnership 19) Distribution of assets upon dissolution of the partnership

A Partnership can be regarded as an improvement on sole proprietorship form of business organization, the minimum number of people that can form a partnership is two, while the maximum is twenty, with the exception of partnerships comprising professionals; for example, lawyers, accountants, doctors, to mention just a few. Notably, most partnerships are usually formed by professionals and those that engage in service oriented business concerns.

Types of Partnership: There are four types of partnership, on the basis of liability of partners (1) **General partnership:** This is a partnership in which all owners share in operating the business and in assuming liability for the business' debts. (2) **Limited partnership:** This is a partnership with one or more general partners and one or more limited partners. Limited partnership is one in which certain partners are liable only for the amount of their investment. This is a special kind of partnership governed by partnership Act of 1907. The purpose of a limited partnership is to allow one or more individuals to provide capital on which a return is expected. In

case of liquidation, the limited partners only lose the capital. (3) **Master Limited Partnership (MLP)**: This is a newer form of partnership which looks much like a corporation in that it acts like a corporation and is traded on the stock exchanges like a corporation but it is taxed like a partnership and thus avoids the corporate income tax. (4) **Limited Liability Partnership (LLP)**: LLP limited partners risk losing their personal assets to only their own acts and omissions of people under their supervision. This newer type of partnership was created to limit the disadvantage of unlimited liability. Types of partners on the basis of the involvement in partnership: An entrepreneur interested in being involved in partnership form of business should endeavor to understand the types of partners that he/she can choose to be in this form of business.

Partners may be classified on the basis of liability, degree of management participation in management share in the profit and so on. The following **types of partners** are organized 1) **General partner**: A general partner is an owner (partner) who has unlimited liability and is active in managing the firm. 2) **Limited partner**: A limited partner is an owner who invests money in the business but does not have any management responsibility or liability for losses beyond the investment. 3) **Silent partners**: These are partners who are known by the public as owners of the business, but they may take no active role in marketing the business. 4) **Secret partners**: These are partners who take active role in the management of the company but they are unknown to the outsiders as partners. 5) **Sleeping partners**: These are also known as dormant partners, they are neither known as partners by the public nor do they participate in managing the company. They only share from the profit /loss of the business to the tune of capital contributed. 6) **Nominal partners**: These kinds of partners are publicly known that they are partners although they have no investment in the business and therefore have no rights of management. They merely lend their names to the enterprise and may be liable for certain debt of the partnership. o How is a general partner different from a sleeping partner? ↘ A general partner is an owner (partner) who has an unlimited liability and is active in the management of the form, a sleeping partner on the other hand do not participate in the day to day running of the business, they only share in the profit /loss of the form. Most often they are not known to the public and partners

Advantages of Partnership: The following are the advantages of Partnership ↘ Easy to establish ↘ More financial resources ↘ Shared management and pooled /complementary skills and knowledge ↘ Division of profits ↘ Minimum governmental regulation/limited legal restrictions ↘ Flexibility ↘ Freedom from double taxation ↘ Secrecy ↘ Longer survival

Disadvantages of Partnership: The following are the diadvantages of Partnersip ↘ Unlimited liability ↘ Division of profits ↘ Disagreement among partners especially with regard to authority and control ↘ Difficult to terminate because partners are bound by the law of agency ↘ Restrictions on transfer of ownership ↘ Lack of continuity

4.2.3 Dissolution and Termination of a Partnership Partners expect their business relationships are going to last forever. However, most do not. There are possibilities that problems may occur when the entrepreneur realizes he or she is not in charge of his or her own company. Even when partnerships work, there are always fears that the partners will develop different business goals. Partners may dissolve or terminate the partnership. Thus dissolution occurs when a general partner ceases to be associated with the business. This may be as a result of:

- ↘ Expiration of a time period or completion of the project undertaken as delineated in the partnership agreement.
- ↘ Expressed wish of any general partner to cease operation.
- ↘ Expulsion of a partner under the provisions of the agreement.
- ↘ Withdrawal, retirement, insanity, or death of a general partner (except when the partnership agreement provides a method of continuation).
- ↘ Bankruptcy of the partnership or of any general partner.
- ↘ Admission of a new partner resulting in the dissolution of the old partnership and establishment of a new partnership.
- ↘ A judicial decree that a general partner is insane or permanently incapacitated, making performance or responsibility under the partnership agreement impossible.
- ↘ Mounting losses that make it unpractical for the business to continue.
- ↘ Impropriety or improper behaviour of any general partner that reflects negatively on the business.

(Adapted from Scarborough et al 2009 pg 87). Termination on the other hand is the final act of intentionally closing the partnership as a business. This can occur after the partners have agreed to cease operations and all affairs of the partnership have been concluded.
o How is Sole Proprietorship different from partnership?
↘ Sole proprietorship is a business established and run by the owner for purpose of meeting needs and making profit, while partnership is a business run by between 2 and 20 partners for purpose of meeting needs and making profit

4.3 Limited Liability Companies The incorporation of companies differs from one country to the other. Each country has a body of laws that guide the registration and operations of companies. In Nigeria, the Companies and Allied Matter Act (CAMA) of 1990 is the major law that guides formation and registration of companies in Nigeria.

4.3.1 Formation of Company and Capacity of Individual According to Section 18 of CAMA 1990, two or more persons may form and incorporate a company by complying within requirements of the act. It also specifies the category of people that can come together to form a company. Section 20 states that anyone in these categories is not qualified:

- ↘ he is less than eighteen years of age;
- ↘ he is of unsound mind and has been so found by a court in Nigeria or elsewhere;
- ↘ he is an un-discharged bankrupt;
- ↘ he is disqualified under Section 254 - which says a person is convicted by a High Court of any offence in connection with the promotion formation or management of a company, etc.

Types of Companies: three types of companies can be identified

- ↘ Limited by shares
- ↘ Limited by guarantee
- ↘ An unlimited company.

A company is said to be limited by shares, if the liability of its members limited by the memorandum to the amount, if any unpaid on the shares respectively held by them.

A company is said to be limited by guarantee if the memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up.

A company is said to be unlimited when the members do not have any limit on the liability of its members.

4.3.2 Private liability Companies The private liability company can be formed by minimum of two persons and maximum of fifty persons excluding employees of the company both past and present (according to Section 22 Subsection 3). The total number of members of a private company shall not exceed fifty, not including persons who are bonafide in the employment of the company or were while in that employment and have continued after the determination of that employment to be, members of the company. The articles of the private company must restrict the transfer of its shares, i.e. the share of the company is not transferable through public offer for subscription. The law also requires the name of private company to end with the word "limited". The public liability company is a company where the shareholders are members of the public. The shares are generally freely transferable. Public companies are large trading concerns with minimum membership of two but no maximum. The name of a public company is expected to end with Public Limited Company (PLC).
o Explain limited liability companies? ↘
Limited liability companies are companies incorporated or registered in Nigeria that is regarded as an artificial person, such company can sue and be sued. They can take the form of private or public companies.

4.3.3 Legal Requirement for Registration of Companies The Companies and Allied Matter Acts specified the documents of incorporation, in section 35 of the acts to include: ↘ Memorandum of Association; ↘ Articles of Association; ↘ Notice of the address of the registered office and head office; ↘ Statement of the lists and particulars of the first directors of the company; ↘ Statutory declaration of compliance with the provisions of the acts ↘ Any other document that may be required by the Corporate Affairs Commission (CAC), e.g. tax certificate of the directors, etc. If the promoters have met the requirements of the CAC, a certificate of incorporation or certificate of registration would be issued and immediately the company becomes an artificial person or legal entity. Memorandum and Articles of Association: These two documents constitute the basic constitution of a company. They are in fact the main incorporation documents. The provision of the Articles of Association is subsidiary to that of the Memorandum of Association. In other words, Memorandum of Association is superior to the Articles of

Association. Wherever there is a conflict between the provisions of the two, that of Memorandum of Association takes pre-eminence prevails. Contents of Memorandum of Association: Section 27 of CAMA 1990 specified the content of the Memorandum of Association. The content include among others: ↘ Name of the company: For a private company to end with (Ltd); public company to end with (PLC), i.e. both are limited by shares. If limited by guarantee to end with limited by guarantee or (Ltd/GTE). No two different companies must have an identical name;

The address of the registered office of the company must be located in Nigeria;
 The object of the company - the type of business and contract the company can lawfully enter into;
 The restriction, if any, on the powers of the company;
 Share capital clause - minimum share capital required for private company is N10,000, while that of public company is N500,000;
 Liability clause - the statement whether the liability of its members are limited or unlimited or limited by share or guarantee;
 Subscription clause - the subscribers of the memorandum are required to subscribe nothing less than 25% of the company's share capital. Each subscriber must write his full names, signature, profession or status as well as address on the column provided.

Content of the Articles of Association: The Articles of Association prescribe the rules and regulations for the internal management of the affairs of the company. The Articles of Association regulates the rights, duties, and obligations of the members among themselves and also the rights, duties and obligations of the members to the company and vice-versa. Other items contained in the document include:

- Membership;
- Meetings, notices of meetings, conduct of meeting;
- Directors, their qualifications, disqualification powers, duties, etc;
- The company borrowing powers;
- Company Secretary;
- Custody of the company's common seal.

Advantages of Limited Liability Companies

- a. It has a legal entity;
- b. Limited liability of shareholders
- c. Ability to attract capital
- d. Ability to continue indefinitely
- e. Transferable ownership
- f. Separation of ownership from management
- g. The death of a shareholder does not mean the end of the company;
- h. Accessibility to large capital which enhance growth.

Disadvantages of limited liability companies

- a. When company becomes very large, there is no personal relationship between the customers and the owners;
- b. Official red tapism may delay decision making;
- c. Chain of command becomes long which lead to communication breakdown.
- d. Cost and time involved in the incorporation process

- e. Double taxation
- f. Charter restrictions
- g. Extensive legal requirement and restrictions
- h. Potential for diminished management incentives
- i. Potential loss of control by the owners
- j. Difficulty of termination
- k. Possible conflict with share stockholders and board of directors

Q How is private Company different from public company? Private company has a maximum number of 50 persons, shares are not subscribed to or transferable by the public and the name must end with "limited" while public company do not have any maximum number of subscribers, shares are publicly subscribed to and transferable through the stock exchange market.

4.4 Co-operative A form of business ownership which involves a collective ownership of a production, storage, transportation or marketing organisation is what is referred to as a co-operative. Some individuals dislike the notions of having owners, managers, workers and buyers as separate parties with separate goals for business organisation. They envision a situation whereby people will co-operate with one another as an association and share the wealth more evenly. This is what necessitates the form of business ownership referred to as cooperatives.

4.4.1 Types of Co-operative Consumer/producer co-operative Workers co-operative Finance co-operatives Co-operatives allow small businesses to obtain quantity discounts on purchases, reducing costs and enabling the co-operative to pass on the savings to its members