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Business Structure

The public sector

The public sector is made up of organisations that **are owned and run by the government**. This part of the economy is huge, and includes some of the largest employers in the UK. The government spends over £450 billion a year running public sector organisations and providing public sector services. The largest public sector organisation, the NHS, is the biggest civilian employer in Europe, costing nearly £120 billion a year to run.

Why do we need a public sector?

Some goods and services which we need in our everyday lives would simply not be provided by the private sector who are looking to make profits. These necessities include street lighting, defence (army, navy, air force) and the police. The problem with these goods is that we can all benefit from them without paying for them. So if someone paid for, and installed street lighting, anyone walking down that road would benefit. If you are benefiting without paying, why pay? These goods which will only be provided by the government are called **public goods**.

Public goods (and services) have two features:

- non-excludability;
- non-rivalry.

Non-excludable: this means that individuals cannot be prevented from enjoying the benefits of the provision of public goods or services. We all gain from having violent criminals kept behind bars, as the threat to our family's well-being is reduced. No individual is excluded from this benefit. The same non-excludability would apply to having public goods such as street lighting – if street lights are provided by a local authority all will benefit from this provision as nobody can be excluded from the benefits.

Non-rivalry: this means that one person gaining from consumption of a good or service does not prevent others from also gaining from the good or service. If an individual eats an ice cream for example, then less ice cream is available for others to consume. Rivalry exists here. However, if an individual benefits from gaining justice in the Law Courts, this does not prevent any other individual from also being able to benefit from such a public service. They are not rivals for this service.

Not all goods provided by the public sector are public goods. There is another group of goods and services that is supplied by both the private and public sectors, but if left to just

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the private sector the quantity supplied of these goods and services is likely to be much less than the level of provision which is most efficient for the economy.

The two best examples of these **merit goods** are education and health care. There are of course private schools and private hospitals but most patients are treated by the NHS, and most children go to state schools. The government spends a great deal of money trying to ensure that we have an effective Health Service and schools and colleges that supply a well-educated and trained workforce. We would **underconsume** merit goods if it were left to the market. Some consumers could not afford the goods; others would fail to see the full benefit of consuming these goods.

These merit goods are said to have **positive externalities**. This means that the consumption of these goods will have positive effects not only on the individual that consumes them, but also on society in general. By attending school, individuals become better educated and skilled. Some individuals may use their knowledge and skills to set up businesses which employ people who themselves will pay tax and contribute to society. So there are positive externalities to education. Also if individuals succeed in school they are less likely to commit crime or require the safety net of the benefits system.

It is because of these positive externalities and likely underconsumption if left to the market, that the government provides merit goods (mainly) free at the point of delivery. Instead of paying to consume these goods or services directly, we pay for them through general taxation.

The public sector is focussed much more on needs than wants. There are public-owned leisure facilities, theatres, museums and so on that look to attract paying customers, but the core role of the public sector is to create **a fair and just society** and, if possible, an efficient economy.

The private sector

This is the part of the UK economy that is operated by businesses owned by shareholders or private individuals.

Although making profits, and giving a return to owners (increasing shareholder value), will always be the number one and two priorities of businesses in the long run, in the short term there can be other important objectives to pursue.

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Objectives of private businesses

Objective	Explanation
To make a profit	To make a return on the capital (money) invested in the business. Profit maximisation is a key expression when considering how successful a business is.
To increase shareholder value	Measured by the dividend paid and the share price. Often the main objective for directors of limited companies. Many senior managers have bonus schemes related to increasing share prices and dividends; achieving the targets within these schemes will then become the main focus of the business.
Survival	In the shorter term this can be more important than making profits as the majority of new businesses fail within the first two years. For a small business, the initial objective is to survive the difficult start-up time of gaining customers, establishing a good local name, and building a reputation. Larger businesses may also have this objective as a priority during recessions when the market is very competitive.
Gaining market share	Businesses may spend to gain customers, reducing profits in the short run, but hopefully increasing profits in the longer term. Some may concentrate on establishing their brand name, becoming the most recognised business in their market. This costs money, so reduces profits.
Improving ethics	For example, there are businesses that will try to minimise the impact of their activities on the environment or ensure that their suppliers get a good deal. Such ethical objectives are likely to increase costs and reduce profits.

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Different business structures

Sole traders

- Sole traders are the most popular form of business in the UK and are run by a single individual. A quick examination of a business directory such as Yellow Pages will show that there are thousands in every town or city.
- Sole traders are easy to set up; it is just a matter of informing the Inland Revenue that an individual is self-employed and registering for class 2 National Insurance contributions within three months of starting in business.
- Costs are low due to the simplicity of setting up and no legal formalities, so there is little administrative cost.
- Also no formal audited accounts are required, though it makes good business sense to keep a full set of business records.
- The sole trader benefits from fast decision-making and may (within employment law) hire and fire as they please.

However, there are a number of problems that arise with the sole trader structure:

- Firstly there is often **limited capital**. Sole traders often rely on their own savings and perhaps secured business loans.
- It is likely that the sole trader will have a **limited range of skills**. A sole trader may be an expert plumber, but is he or she an expert at marketing, managing staff, and controlling cash flow? With the need to be effective at all these tasks comes immense pressure.
- All the **decisions** and the future success of a business **rest with one person**.
- The sole trader has **unlimited liability**. This means that the business owner is liable for all the debts of the business, up to and including the value of all assets held.

One of the major problems of running a small business is the likelihood of falling into debt. With one in three businesses failing within two years of starting, it is probable that a good proportion of those unsuccessful entrepreneurs will not only lose the money that they initially invested, but additional money too.

Imagine a situation where a sole trader opens a shop selling fashion accessories. The shop premises are let on a two year lease; she (the entrepreneur) arranges a phone contract for the shop, leases equipment like a checkout till and shop fittings – all for the same two years. The total amount payable per month comes to £1300. Unfortunately after 9 months she has run out of cash, sales were dismal and she can't afford to continue.

She tries to walk away, handing the keys back, cancelling the phone contract and the lease deals. However, it is not that easy, she is in fact liable for ongoing costs – paying for a further 15 months charges, a total of £19,500 (15 months times £1300). Her creditors (those she

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owes money to), will chase her through the courts for payment, and if she has assets, the creditors can ask the courts to seize and sell these assets to pay the money owed. Assets can be anything of value – a car, computer, TV or even a house. The problem is that sole traders (and most partnerships) have unlimited liability – the owners of the business are liable for all the debts of their business, and have to pay those debts if they are able.

Partnerships

- Partnerships involve the **joint ownership** of a business. Normally there can be between two and 20 partners, but in certain businesses such as accountancy firms, there can be many more partners than this.
- Partnerships are **often found in professions** such as lawyers, accountants and doctors, but can be found in any type of business activity.
- The rules of partnership are laid down in a **Partnership Agreement**, or the Deed of Partnership. The Deed of Partnership lays out such rules of operations as the amounts of capital invested, the share of profits each partner is to receive, the roles and responsibilities of each partner, the voting shares of the partners, what is to happen on the death of a partner and the rules for dissolution of the partnership.
- Should a dispute arise without a partnership agreement giving methods of settling the dispute, then the dispute would be settled according to the **1890 Partnership Act**. This is best avoided, particularly where unlimited liability is involved, as the act states that each partner is equally responsible for any debts – each partner is 'jointly and severally' liable.
- There are a number of **advantages of the partnership structure over that of a sole trader**. These include a wider range of skills, greater availability of capital, shared decision-making, and pressure is likely to be reduced with different partners having separate key roles.

However, becoming a partner does not overcome all the disadvantages of being a sole trader:

- **Capital can still be limited**, with the same problems of raising external capital that a sole trader has.
- The partners still have **unlimited liability** of partners (sleeping partners who invest, but take no part in the day-to-day running of the business can have limited liability).
- Also partnerships are **dissolved on the death of a partner** and this can cause complications in re-establishing the partnership.
- Although there are many advantages when partners become involved in a business for the first time (such as increased capital, greater input into decision-making, a wider spread of skills), new partners can, and do, cause **strains** within a business.

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Limited companies

There are two types of business structure that have limited liability:

- private limited companies (Ltd);
- public limited companies (PLC).

These businesses exist separately from their owners, who are known as **shareholders**. Employees are employed by the Ltd or PLC, and assets (buildings, machinery) are owned by the Ltd or PLC. This separate legal existence is known as **incorporation** – the business exists in the eyes of the law. Any legal action is taken against the business and not the shareholders. Shareholders are only liable to lose the amount of money they have invested in the business – hence, their liability is limited.

Although they have the same type of liability there is one major difference. Public limited companies trade their shares on the stock market. In the UK there are two main stock markets. These are:

- The Alternative Investment Market (AIM) – for smaller companies;
- The London Stock Exchange (LSE) – for larger businesses.

Shares on these stock markets are freely bought and sold: so in effect the ownership of PLCs are changing all the time. This change of ownership normally has very little impact on the running of the business. One small shareholder sells their shareholding, another small shareholder buys, and this happens thousands of times a day.

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Advantages of private limited companies include:

- limited liability;
- shares can only be sold if all the shareholders agree – control is not lost to outsiders;
- capital can be raised through increasing shareholders;
- other businesses and lenders are more likely to trade and invest;
- the business continues if one of the owners dies;
- possible tax advantages for the owners.

However, disadvantages include:

- legal procedure in setting up, increases costs;
- profits have to be shared with shareholders;
- shares cannot be sold to the public which may restrict the investment of additional capital;
- financial information is in the public domain.

Advantages of public limited companies include:

- limited liability;
- the business continues if one of the owners dies;
- capital can be raised through selling shares to the public;
- it is easier to raise finance from banks and other lenders who are more willing to lend to PLCs;
- they are likely to have economies of scale;
- increased market presence and dominance.

However, disadvantages include:

- increased costs in setting up;
- anyone can buy shares so there is an increased threat of losing control;
- increased legal requirements;
- the company accounts are in the public domain – more information has to be published than private limited companies;
- divorce of ownership and control;
- the increased size may result in inefficiencies, increased costs and distance from their customers.

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Not-for-profit organisations

There are a growing number of business organisations that are not in business for the money – they are not out to maximise profits. Instead their focus is on social or ethical objectives. Within this group of organisations we find charities, co-operatives and social enterprises, between them providing a range of goods and services, and more often than not competing with 'for-profit businesses'. These not-for-profit organisations cannot just sell on the basis of who they are or what they stand for – if they just did this it is unlikely they would last for long. They have to provide a quality and value-for-money service, just like any other business.

Charities

Charities are established with the aim of collecting money from individuals and spending it on a cause, which is usually specified in its title. Although they are not established to make profits, they can earn surpluses. Many well-known charities such as Oxfam, Friends of the Earth and Save the Children have been around for a long time and employ many people. Oxfam was started in 1942; the RSPCA began over 100 years earlier, in 1824. Charities can often have a narrow focus (single issue) in what they are trying to achieve. For example, the Big Issue's mission statement is:

> Our mission as a UK charity for people who are homeless, is to connect vendors with the vital support and personal solutions that enable them to rebuild their lives; to find their own paths as they journey away from homelessness.

Other charities have a broader perspective (multi-issue). Greenpeace state that their mission is to:

> Defend the natural world and promote peace by investigating, exposing and confronting environmental abuse, [and] championing environmentally responsible solutions.

Charities still raise the majority of their finances through voluntary donations, but more and more charities now operate retail outlets as well. Oxfam have been doing this for a number of years and their shops contain new items often produced as a result of their development projects, as well as donated items such as books and clothes. There are hundreds of local charities who operate handfuls of shops within specific areas, all relying on donated goods. These shops have thrived as vacant premises have appeared on high streets up and down the country. Rents are cheap, and costs are low – often volunteer staff work in the shops.

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Co-operatives

Business co-operatives were initially set up in the 19th century as part of a social movement by working people. They were established around workplaces or in districts of industrial towns, and were designed to prevent profiteering and exploitation by company shops and tallymen (door-to-door lenders).

The historic background of British Co-operatives can be found on the Guardian newspaper website. To find out much more just enter the term 'co-operative history', in the Guardian website search box.

A co-operative is an organisation owned by its members. Employees of co-operatives automatically become members after a short probationary period, and shoppers at co-operative shops such as 'the Co-op', can apply to become members: acceptance is automatic. Members benefit through the payment of a dividend (their share of the co-operatives profits) in the form of money-off vouchers.
Just like any business, co-operatives have managers and there is a business hierarchy, but it is much flatter than that found in a typical business – there are fewer layers to the hierarchy. Pay differentials between the most senior and most junior workers may be just 2 or 3 times (it is likely to be 30 times or more in a PLC). When major decisions need to be made, each member has an equal vote. Shoppers at the 'Co-op' have the right to vote for elected members and can actually stand in the election for representatives of the Co-operative Group.

Worker co-operatives are businesses which are owned and controlled by those who work in it. They often take the form of producer co-operatives, where people work together to produce a good or a service. As owners of the business, all employees are likely to be well motivated because they are all working towards the same goal. Some examples in the UK include various farmers' co-operatives and the Edinburgh Bicycle Co-operative, which retails bicycles.

Social enterprises

Social enterprises are a booming organisation structure. They are businesses with clear social objectives and are currently thriving in a number of industries and sectors of the economy.

- Social enterprises trade to help solve social problems, improve the communities they operate in, and improve the environment.
- Many social enterprises aim to make profits from selling goods and services in the open market; but then, instead of paying dividends, they reinvest these profits, towards achieving their social objectives.

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- The chef Jamie Oliver has had great success with his '15' chain of restaurants, providing training in a range of cooking and catering skills for homeless and unskilled young people. Profits from the first restaurant go towards opening new restaurants and spreading the benefits to a larger number.
- The government is looking at the social enterprise model as a way of providing services such as child protection. Other social enterprises operate in the housing, drinks and holiday sectors, as well as many other sectors, and the number of social entrepreneurs is rapidly growing.
- Many young people, fresh out of university, are looking for a type of satisfaction from work that cannot come from employment in a large business, and the social enterprise structure offers them this motivational opportunity.

Activities	
Discussion themes	Discuss the following statement: 'With a thriving and competitive private sector, the UK has no need of a public sector.' Discuss the following statement: 'Maximising profits will always be the number one business priority.' Explain the motivation shareholders of a private limited company may have in deciding to take their company public. Discuss the following statement: 'Co-operatives will never be able to compete and be successful in the modern business environment.' Discuss the following statement: 'Unlimited liability is the biggest disadvantage of operating as a sole trader.' Explain why limited companies are more likely to be successful than unlimited businesses in obtaining external finance in order to expand.

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See the article about what makes a social enterprise for an in-depth description of how social enterprises operate: **http://www.socialenterprise.org.uk/advice-services/publications/social-enterprise-explained**	
Teachers TV Video Watch the video on DC7 vending	What features of being a sole trader are shown in the video?