FORMS OF BUSINESS UNITS

TOPIC OBJECTIVES

By the end of the topic, the learner should be able to:

1. Identify the various forms of business units.
2. Explain the characteristics of each form of business unit.
3. Discuss the formation and management of each form of business unit.
4. Discuss the sources of capital of each form of business unit.
5. Discuss the role of stock exchange as a market for securities.
6. Explain the advantages and disadvantages of each form of business unit.
7. Recognize the circumstances under which each form of business units may be dissolved.
8. Discuss trends in business ownership.

SUB TOPICS

1. Un incorporated forms of business units
    a) Sole proprietorship
    b) Partnership
2. Incorporated forms of business units
    a) Cooperatives
    b) Private limited companies
    c) Public limited companies
    d) Public corporations.
    e) Parastatals.
3. Features of each form of business unit
4. Formation and management of each form of business unit
5. Sources of capital for each form of business unit
6. Role of stock exchange market as a market of securities.
7. Advantages and disadvantages of each form of business unit.
8. Dissolution of business units.
9. Trends in forms of business units:
    - Globalization
    - Amalgamation/ mergers
    - Privatization
    - Holding companies
    - Trusts etc

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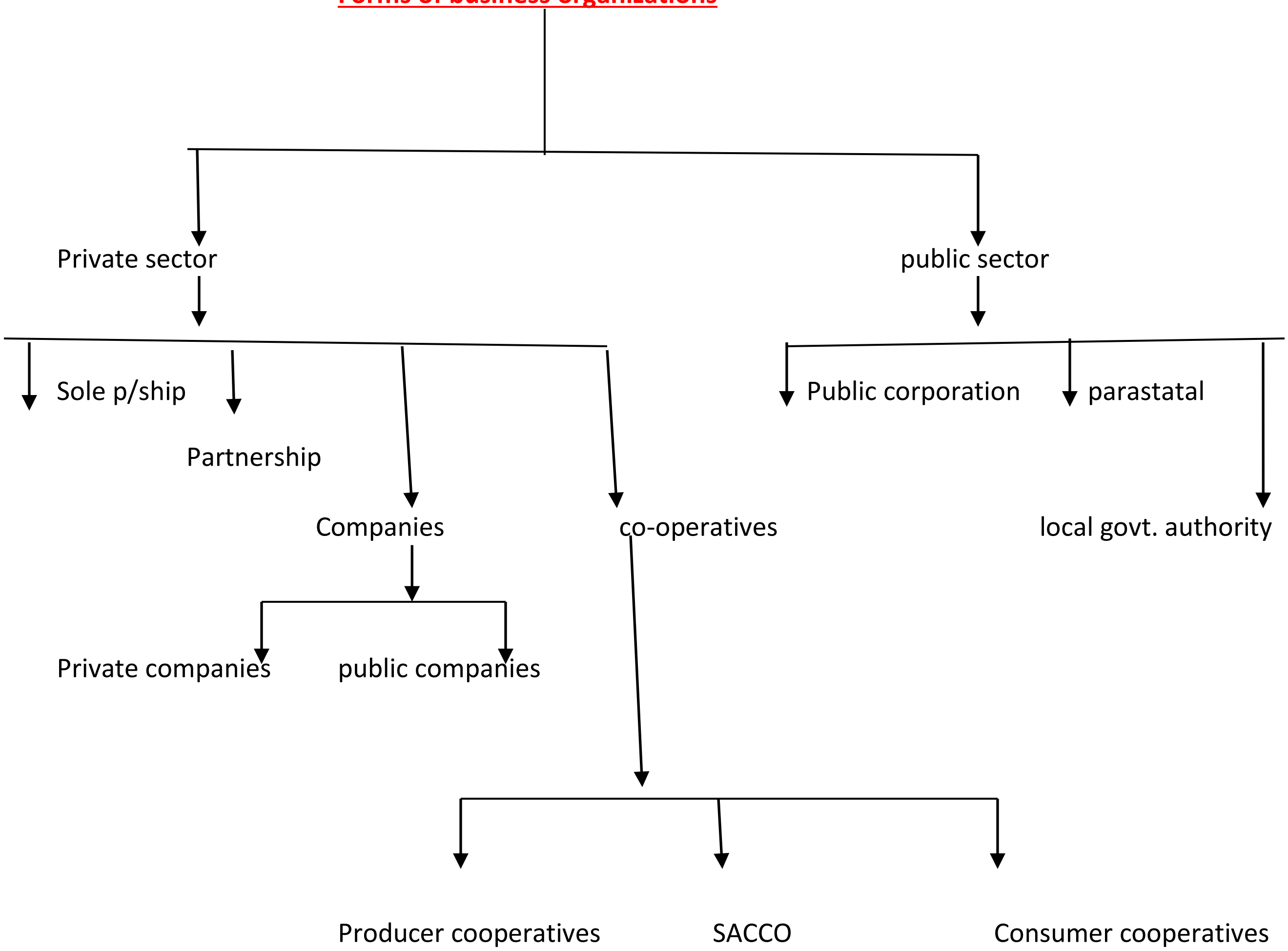
BUSINESS UNITS

A business unit is an organization formed by one or more people with a view of engaging in a profitable activity.

Business units are generally classified into private or public sector business units' i.e

Forms of business organizations



Note: Private sector comprises of business organizations owned by private individuals while the public sector comprises business organizations owned by the government

1. *Sole proprietorship*

This is a business enterprise owned by one person who is called ***a sole trader or a sole proprietor.*** It is the most common form of business unit and usually found in retail trade e.g. in small shops, kiosks, agriculture e.t.c and for direct services e.g. cobblers saloons e.t.c

Characteristics/Features

- The business is owned by one person
- The capital is contributed by the owner and is usually small. The main source is from his savings and other sources can be from friends, bank or getting an inheritance
- The owner enjoys all the profits alone and also suffers the losses alone
- The owner is personally responsible for the management of the business and sometimes he is assisted by members of his family or a few employees. He remains responsible for the success or failure of his/her business.
- The sole proprietor has unlimited liability meaning that incase of failure to meet debts, his creditor can claim his personal property
- There are very few legal requirements to start the business unit.
- Sole proprietorship is flexible; it is very easy to change the location or the nature of business.

Formation

The formation of a sole proprietorship is very simple. Few legal formalities are required i.e. to start a sole proprietorship, one need only to raise the capital required and then apply for a trading license to operate the business small fee is paid and the trade license issued.

Sources of capital

The amount of capital required to start a sole proprietorship is small compared to other forms of business organizations. The main source of capital is the ***Owners savings.*** Additional capital may however be raised from the following;

- Borrowing from friends, banks and other money lending institutions such as industries and commercial Development corporation(ICDC)and Kenya industrial estates
- Inheritance
  Personal savings
- Getting goods on credit
- Getting goods on hire purchase
- Leasing or renting out one’s properties
- Donations from friends and relatives
- Ploughing back profit.

Management

The management of this kind of a business is under one person. The owner may however employ other people or get assistance from family members to run the business.

Some sole proprietorship may be big business organizations with several departments and quite a number of employees. However, the sole proprietor remains solely responsible for the success of failure of the business.

Advantages of sole proprietorship

1. The capital required to start the business is small hence anybody who can spare small amounts of money can start one.
2. Few formal/legal procedures are required to set up this business
3. Decision making and implementation is fast because the proprietor does not have to consult anybody
4. The trader has close and personal contact with customers. This helps them in knowing exactly what the customers need and hence satisfying those needs
5. A sole proprietor is able to assess the credit-worthiness of his or her customers because of close personal relationship. Extending credit to a few carefully selected customers reduce the probability of bad debts.
6. The trader is accountable to him/herself
7. A sole trader is able to keep the top secrets of the business operations
8. He/she enjoys all the profit
9. A sole proprietorship is flexible. One can change the nature or even the location of business as need arises.

Disadvantages of sole proprietorship

1. Has unlimited liability. This means that if the assets available in the business are not enough to pay all the business debts the personal property of the owner such as house will be sold to meet the debts
2. There is insufficient capital for expansion because of scarce resources and lack of access to other sources
3. He/she is overworked and has no time for recreation.
4. There is lack of continuity in the sole proprietorship i.e the business is affected by sickness or death of the owner.
5. A sole proprietorship may not benefit from advantages realized by large scale enterprises (economies of large scale) such as access to loan facilities and large trade discounts.
6. Lack of specialization in the running of the business may lead to poor performance. This is because one person cannot manage all aspects of the business effectively. One maybe a good salesman for examples but a poor accountant.

7. Due to the size of the business, sole proprietorships do not attract and retain highly qualified and trained personnel.

Dissolution of sole proprietorships

Dissolution refers to the termination of the legal life of a business.
The following circumstances may lead to the dissolution of a sole proprietorship:

- Death or insanity of the owner.
- Transfer of the business to another person- this transfers the rights and obligations of the business to the new owner.
- Bankruptcy of the owner- this means that the owner lacks the financial capability to run the business.
- The owner voluntarily decides to dissolve the business e.g due to continued loss making.
- Passing of a law which renders the activities of the business illegal.
- The expiry of the period during which the business was meant to operate.

PARTNERSHIP:

This is a relationship between persons who engage in a business with an aim of making profits/ an association of two or more persons who run a business as ***co-owners***. The owners are called ***Partners.***

It is owned by a minimum of 2 and a maximum of 20 except for partnership who provide professional services e.g medicine and law which have a maximum of 50 persons.

Characteristics of partnership

- Capital is contributed by the partners themselves.
- Partnership has limited life that is it may end anytime because of the death, bankruptcy or withdrawal of partners.
- Each partner acts as an agent of the firm with authority to enter into contracts.
- Partners are co owners of a business, having an interest or claim in the business.
- Responsibility, profit and losses are shared on an agreed basis.
- All partners have equal right to participate in the management of the business. This right arises from the interest or claim of the partner as a co owner of the business.

_Types of partner_ship

Partnerships can be classified/ categorized in either of the following ways:

(a) According to the type/liability of partners
(b) According to the period of operation
(c) According to their activities.

(a) **According to the type or liability of partners**
Under this classification, partnerships can either be;

i) ***General/ordinary partnership***

Here all members have unlimited liability which means in case a partnership is unable to pay its debts, the personal properties of the partner will be sold off to pay the debts.

ii) Limited partnerships

In limited partnership members have limited liabilities where liability or responsibility is restricted to the capital contributed.

This means that incase the partnership cannot pay its debts; the partners only lose the amount of capital each has contributed to the business and not their personal property. However, there must be one partner whose liabilities are unlimited.

(b) **According to the period/duration of operation**
When partnerships are classified according to duration of operation, they can either be;

I) Temporary partnership
These are partnerships that are formed to carry out a specific task for a specific time after which the business automatically dissolves.

ii) Permanent partnerships
These are partnerships formed to operate indefinitely.
They are also called a partnership at will.

(c) **According to their Activity**
Under this mode of classification, partnerships can either be:

i) Trading partnerships
This is a partnership whose main activity is processing, manufacturing, construction or purchase and sale of goods.

ii) Non – trading partnerships
This is a partnership whose main activity is to offer services such as legal, medical or accounting services to members of the public.

Types of partners

Partners may be classified according to;

i) Role played by the partners

a) Active partner; He is also known as acting partner as he plays an active part in the day-to-day running of the business.

b) ***Sleeping/dormant partner;*** He does not participate in the management of the partnership business.

   -Although he invests his capital in the partnership, his profit is lower as he is not active
   -He is also referred to as passive or silent partner

ii) Liabilities of the partners for the business debts;

a) ***General partner;*** He/she has unlimited liabilities.
b) ***Limited partner;*** He/she has limited liabilities

iii) Ages of partners

a) ***Major partner;*** This is a partner who is 18 years and above.

He is responsible for all debts of the business.

b) ***Minor partner;*** This is a partner who has not attained the age of 18 years but has been admitted with the consent of other partners.

   -Once he reaches 18 years, he then decides if he wants to be a partner or not.
   -Before he attains the age of 18, he takes part in the sharing of profits but does not take part in the management of the business.

iv) Capital contribution

a) ***Nominal/Quasi partner;*** He does not contribute capital but allows the business to use his/ her name as a partner; for the purpose of influencing customers or for prestige.

   -He/she can also be a person who was once a partner and has retired in form of a loan. This loan carries interest at an agreed rate.
   -The quasi partner shares the profit of the business as a reward for using his/her name.

b) ***Real partner;*** He/she is one who contributes capital to the business.

-Other types of partners include secret partners, retiring partners and incoming partners

i) A secret partner; is one who actively participates in the management of the firm but is not disclosed to the public. In most cases secret partners are also limited partners.

ii) A retiring partner; Also known as outgoing partner is one who is leaving a partnership

-He may retire with the consent of all the other partners or according to a previous agreement.

iii) Incoming partner; Is one who is admitted to an existing partnership.

Formation

-People who want to form a partnership must come together and agree on how the proposed business will be run to avoid future misunderstanding.

-The agreement can either be oral (by use of mouth) or within down. A written agreement is called a ***partnership deed.***

-The contents of the partnership deed vary from one partnership to another depending on the nature of the business, but generally it contains;

a) Name, location and address of the business
b) Name, address and occupation of the partners
c) The purpose of the business
d) Capital to be contributed by cash partner
e) Rate of interest on capital
f) Drawings by partners and rate of interest on drawings
g) Salaries and commissions to partners
h) Rate of interests on loans from partners to the business
i) Procedures of dissolving the partnership
j) Profit and loss sharing ratio
k) How to admit a new partner
l) What to do when a partner retires dies or is expelled
m) The rights to inspect books of accounts
n) Who has the authority to act on behalf of other partners.

Once the partnership deed is ready, the business may be registered with the registrar of firms on payment of a registration fee.

In case a partnership deed is not drawn, the provisions of partnership act of 1963 (Kenya)applies. The act contains the following rights and duties of a partner;

i) All partners are entitled to equal contribution of capital
ii) No salary is to be allowed to any partner
iii) No interest is to be allowed on capital
iv) No interest is to be charged on drawings

v) All profits and losses are to be shared equally
vi) Every partner has the right to inspect the books of accounts
vii) Every partner has the right to take part in decision making
viii) Interest is to paid on any loans borrowed by partners (The % rate varies from one country to another)
ix) During dissolution the debts from outside people are paid first then loans from partners and lastly partners capital.
x) No partner should carry out a competing business
xi) Any change in business such as admission of new partners must be through the agreement of all existing partners.
xii) Compensation must be given to a partner who incurs any loss when executing the duties of the business.

Sources of capital

i) Partners contribution
ii) Loans from banks and other financial institutions
iii) Getting items on hire purchase
iv) Trade credit
v) Ploughing back profit
vi) Leasing and renting.

Advantages of partnership

i) Unlike sole proprietorship, partnership can raise more capital.
ii) Work is distributed among the partners. This reduces the workload for each partner
iii) Varied professional/skilled labour; various partners are professionals in various different areas leading to specialization
iv) They can undertake any form of business agreed upon by all the partners
v) There are few legal requirements in the formation of a partnership compared to a limited liability company.
vi) Losses and liabilities are shared among partners
vii) Continuity of business is not affected by death or absence of a partner as would be in the case of a sole proprietorship
viii) Members of partnership enjoy more free days and are flexible than owners of a company
ix) A Partnership just like sole proprietorship is exempted from payment of certain taxes paid by large business organizations.

Disadvantages of partnership

i) A mistake made by one of the partners may result in losses which are shared by all the partners

ii) Continued disagreement among the partners can lead to termination of the partnership
iii) Decision-making is slow since all the partners must agree
iv) A partnership that relies heavily on one partner may be adversely affected on retirement or death of the partner
v) A hard working partner may not be rewarded in proportion to his/her effort because the profits are shared among all the partners
vi) There is sharing of profits by the partners hence less is received by each partner
vii) Few sources of capital, due to uncertainty in the continuity of the business few financial institutions will be willing to give long-term loans to the firm.

Dissolution of partnership

A partnership may be dissolved under any of the following circumstances:

i) A mutual agreement by all the partners to dissolve the business
ii) Death insanity or bankrupting of a partner
iii) A temporary partnership on completion of the intended purpose or at the end of the agreed time.
iv) A court order to dissolve the partnership
v) Written request for dissolution by a partner
vi) If the business engages in unlawful practices
vii) Retirement or admission of a new partner may lead to a permanent or temporary dissolution
viii) Continued disagreements among the partners

INCORPORATED FORMS OF BUSINESS UNITS

These are businesses that have separate legal entities from that of their owners. They include:

CO-OPERATIVES

-A co-operative society is a form of business organization that is owned by and run for the economic welfare of its members

-It is a body of persons who have joined together to do collectively what they were previously doing individually for mutual benefit.

Example

In Kenya the co-operative movement was started by white settlers in 1908 to market their agricultural produce. In this case, they knew that they could sell their produce better if they were as a group and not alone

Principles of co-operatives

i) Open and voluntary membership

Membership is open and voluntary to any person who has attained the age of 18 years. No one should be denied membership due to social, political, tribal or religious differences.

A member is also free to leave the society at will

ii) Democratic Administration

The principle is one man one vote. Each member of the co-operative has only one vote irrespective of the number of shares held by him or how much he buys or sells to the society

iii) Dividend or repayment

-Any profit/surplus made at the end of every financial year should be distributed to the members in relations to their contribution.

-Part of the profit may be retained/reserved/put in to strengthen the financial position of the society.

iv) Limited interest on share capital

-A little or no interest is paid on share capital contributed (co-operatives do not encourage financial investment habits but to enhance production, to encourage savings and serve the members)

v) Promotion of Education

Co-operative societies should endeavor to educate their members and staff on the ideas of the society in order to enhance/improve quality of decisions made by the concerned parties.

Education is conducted through seminars, study tours, open days

vi)***Co-operation with other co-operatives***

C-operatives must learn from each others experience since they have a lot in common.

-Their co-operation should be extended to local national and international.

Features of co-operatives

- Membership is open to all persons so long as they have a common interest. Members are also free to discontinue their membership when they desire so
- Co-operative societies have a perpetual existence; death, bankruptcy or retirement of a member does not affect its operations
- They are managed in a democratic manner. Every member has one vote when electing the managerial committee irrespective of the number of shares held.

- The main aim is to serve the interest of the members where profit is not the over riding factor.
- Co-operative societies have limited liabilities
- There must be a minimum of 10 people with no maximum membership.
- Co-operatives have a separate legal entity from the members who formed it i.e they can own property sue and be sued
- Any profit made by the society is distributed to the members on the basis of the services rendered by each member but not according to the capital contributed.

Formation

-Co-operative societies can be formed by people who are over eighteen years regardless of their economic, political or social background.

-There must be a minimum of 10 persons and no maximum no.

-The members draft rules and regulations to govern the operations of the proposed society i.e. by-laws, which are then submitted to the commissioner of co-operatives for approval

-The registrar then approves the by-laws and issues a certificate of registration

-If the members are unable to draw up their own by-laws, the co-operative societies Act of 1966 can be adopted in part or whole

Management

-A co-perative society is composed/run by a committee usually of nine members elected by the members in a general meeting

-The management committee elects the chairman, secretary and treasurer as the executive committee members, who act on behalf of all the members and can enter into contracts borrow money institute and depend suits and other legal proceedings for the society

-The committee members can be voted out in an A.G.M if they don’t perform as expected.

TYPES OF CO-OPERATIVES SOCIETIES IN KENYA

May be grouped according to;

i) ***Nature of their activities***

a) Producer co-operatives

b) Consumer co-operatives
c) Savings and credit co-operatives

ii) ***Level of operations***
a) Primary co-operatives
b) Secondary co-operatives

a) Producer co-operatives

This is an association of producers who have come together to improve the production and marketing of their products.

Functions

- Obtaining better prices for their members products
- Providing better storage facilities for their products
- Providing better and reliable transport means for moving the products from the sources to the market and building feeder roads
- Providing loans to members
- Providing services of grading, packing and processing to the members
- Providing farm inputs e.g. fertilizers, seeds, insecticides e.t.c on credit to members
- Educating and advising members on better methods of farming through seminars, field trips, films and demonstration

-In this type of co-operative members are paid according to the quantity of the produce a member has delivered to the society.

Examples,

KCC-Kenya Co-operative Creameries

K.P.C.U-Kenya Planters Co-operatives Union

K.G.G.C.U-Kenya Grain Growers Co-operative Union

b) Consumer Co-operatives

-These are formed by a group of consumers to buy goods on wholesome and sell them to the members at existing market prices.

-Their aim is to eliminate the wholesalers and retailers and hence obtain goods more cheaply

-The co-operatives allow their members to buy goods on credit or in cash

-Members of the public are also allowed to buy from the society at normal prices thereby enabling the society to make more profits

-The profits realized is shared among the members in proportion to their purchases i.ethe more a member buys, the buyer his/her share of profit

Examples

-Nairobi consumer co-operative union

-Bee-hive consumer co-operative society

-City-chicken consumer co-operative society

Advantages

- Sell goods of high quality
- Sell goods to members at fair prices
- Sell goods to other people at normal prices thereby making more profit
- Buy goods directly from the producers thereby eliminating middlemen. They are therefore able to make more profit
- Can give credit facilities to the members
- Can pay interest on capital to the members
- Sell a variety of goods to the members at a place where they can easily get them

Disadvantages

Consumer co-operatives are not popular in Kenya because of the following

i. They face stiff competition from large scale retailers such as supermarkets and multiple shops who buy goods directly from the producers and sell-them to consumers at low prices
ii. Cannot offer to employ qualified staff
iii. Majority of their members have low income, so raising off capital is a problem
iv. Kenya, being an agricultural country, produces enough subsistence goods for itself. It therefore does not require consumer co-operatives
v. Reluctance of non-members to buy from the shops lowers the turn-over
vi. Mismanagement of the shops is rampant

Savings and credit co-operatives societies (SACCO'S)

-They are usually formed by employed persons who save part of their monthly salary with their co-operative society, through check-off system

-Their money earns goods interest and when one has a significant amount saved, he/she become entitled to borrow money from the society for any personal project e.g. improving their farms, constructing houses, paying school fees e.t.c

-The SACCOS charge lower interest on loans given to members than ordinary banks and other financial institutions.

-The societies have few formalities or requirements to be completed before giving a loan. These are:

i. *Membership*
ii. *Members salary*
iii. *Members saving*
iv. *Guarantee from fellow members*

-Profits earned by the SACCO'S maybe shared among the members inform of dividends.

-Most SACCO'S have insured their members savings and loans with co-operative insurance services (CIS).This means if a member dies his/her beneficiaries are not called upon to repay the loan and the members savings/shares is given to the beneficiaries.

-They are the main institutions that provide loans to most people who do not qualify for loans from commercial banks because they do not ask for securities such as title deeds required by the bank.

d) Primary co-operative societies

-These are co-operative societies composed of individuals who are either actual producers, consumers or people who join up together to save and obtain credit most conveniently

-Consumer co-operative societies and most SACCO'S are primary co-operative societies because they are composed of individuals.

-Most primary co-operative societies operate at the village level, others at district levels and a few at national levels.

e) Secondary co-operative societies

-They are usually referred to as unions

-They are generally composed of primary co-operative societies as their members

-They are either found at district levels or at national levels.

Advantages of co-operative societies;

- Since the properties of co-operatives are owned collectively, they are able to serve the interest of the members affectively

- They have limited liability
- Membership is free and voluntary
- Members share profits of a co-operative through dividend that are given
- They have improved the standards of living of their members through increased income from their produce and through savings from incomes.
- Co-operatives benefit their members through giving them credit facilities and financial loans which they could not have got from local banks
- They are run on a democratic basis i.e. all members have an equal chance of being elected to the management committee.
- Many co-operatives are large scale organizations hence able to get the benefits of large scale organizations e.g low production costs leading to low prices of products
- Co-operative enjoy a lot of support from the government and when they are in financial and managerial problems, the government steps in to assist them

Disadvantages

- Majority of the co-operatives are small in size and therefore cannot benefit from economies of scale.
- Members have a right to withdraw from the society and when they do, co-operatives refunds the capital back which might create financial problems to the society.
- Corruption and embezzlement of funds is a problem for many co-operatives.
- Most co-operatives are not able to attract qualified managerial staff hence leading to mismanagement.
- Many suffer from political interference. Sometimes; the election of the management committee is interceded with by some people with personal interest in certain candidates hence the best person may not be elected to run the affairs of the society. This leads to poor management and inefficiency.
- Members may not take keen interest in the affairs of a co-operative society because their capital contribution is small.

Dissolution of co-operative societies

-A co-operative society may be dissolved under any of the following circumstances.

i. Order from commissioner of co-operatives
ii. Voluntary dissolution by members
iii. Withdrawal of members from the society leaving less than ten members
iv. If the society is declared bankrupt

LIMITED LIABILITY COMPANIES (JOINT STOCK COMPANIES)

Defn: A company; Is an association of persons registered under the companies act who contribute capital in order to carry out business with a view of making a profit.

The act of registering a company is referred to as **incorporation. Incorporation** creates an organization that is separate and distinct from the person forming it.

-A company is a legal entity that has the status of an ''**artificial person".** It therefore has most of the rights and obligations of a human being. A company can therefore do the following;

- Own property
- Enter into contracts in its own name.
- Borrow money.
- Hire and fire employees.
- Sue and be sued in its own right.
- Form subordinate agencies, ie, agencies under its authority.
- Disseminate or spread information.

-The owners (members) of a company are referred to as shareholders

FEATURES OF COMPANIES (LIMITED LIABILITY COMPANIES)

-A company in an artificial person and has the same rights as a natural person. It can therefore sue and be sued in a court of law, own property and enter into contracts in its own name.

-The members have limited liabilities.

-Companies have perpetual life which is independent of the lives of its owners. Death, insanity or bankruptcy of a member does not affect the existence of the company. (this is referred to as **perpetual existence or perpetual succession)**

- A company is created for a particular purpose or purposes.

Formation

-People who wish to form company are referred to as ***promoters***

-The promoters submit the following documents to the registrar of companies:

i) Memorandum of Association

-This is a document that defines the relationship between the company and the outsiders. It contains the following:

a) ***Name of the company/Name clause;***

-The name of the company must be started and should end with the word "*Limited"(Ltd).*This indicates that the liability of the company is limited

-Some companies end their names with ***"PLC"***which stands for "***Public limited company"*** which makes the public aware that although it is a limited liability company it is a public not private.

b) ***The objects of the company/objective clause***

-This sets out the activities that the company should engage in

-The activities listed in this clause serve as a warning to outsiders that the company is authorized in these activities only.

c) ***Situation clause;*** Every company must have a registered office where official notices and other communication can be received and sent

d) ***Capital clause;*** It also states that the amount of capital which the business can raise and the divisions of this capital into units of equal value called shares i.e. authorized share capital also called registered or nominal share capital.

-It also specifies the types of shares and the value of each share

e) ***Declaration clause:***

-This is a declaration signed by the promoters stating that they wish to form the company and undertake to buy shares in the proposed firm

-The declaration is signed by a minimum of seven promoters for public limited company and a minimum of two for private company.

-The memorandum of association also contains the names of the promoters

-The promoters signs against the memorandum showing details of their names, addresses, occupation and shares they intend to buy. Each signatory should agree to take at least one share.

ii) ***Articles of Association***

-This is a document that governs the internal operations of the company

-It also contains rules and regulations affecting the shareholders in relation to the company and in relation to the shareholders themselves.

-It contains the following;

- Rights of each type of shareholder e.g voting rights
- Methods of calling meeting and procedures
- Rules governing election of officials such as chairman of the company, directors and auditors

- Rules regarding preparation and auditing of accounts
- Powers, duties and rights of directors
- Methods dealing with any alterations on the capital

iii) A list of directors with details of their names, addresses, occupations, shares subscribed and statements of agreement to serve as directors.

iv) Declaration that registration requirements as laid down by law (by the companies act) have been met. The declaration must be signed by the secretary or a director or a lawyer.

v)A statement signed by the directors stating that they have agreed to act as directors.

vi) A statement of share capital- this statement gives the amount of capital that the company wishes to raise and its subdivision into shares.

-Once the above documents are ready, they are submitted by the promoters to the registrar of companies. On approval by the Registrar and on payment of a registration fee, a certificate of incorporation (certificate of registration) is issued

-The certificate of incorporation gives the company a separate legal entity.

Sources of capital

1) ***Shares;*** The main source of capital for any company is the sale of shares.

-A share is a unit of capital in a company e.g. if a company states that its capital is ksh.100,000 divided into equal shares of ksh.10 each.

-Each shareholder is entitled to the company's profit proportionate to the number of shares he/she holds in the company

Types of shares;

a) Ordinary shares
b) Preference shares

a) Ordinary shares

Ordinary shares have the following rights:

- Have voting rights
- Have no fixed rate of dividends. The dividends on them vary according to the amounts of profit made
- They have a claim to dividends after the preference shares
- If the company is being liquidated, they are paid last after the preference shares

b) Preference shares

They have the following characteristics;

- Have a fixed rate of sharing profits(dividends)
- Have a prior claim to dividends over the ordinary shares
- Have no voting rights
- Can be redeemable or irredeemable. Redeemable shares are the ones that can be bought back by the company at a future date while irredeemable ones are ones that cannot be bought back
- Can be cumulative or non-cumulative. Cumulative shares are the ones that are entitled to dividends whether the company makes profit or not. This means if the company makes a loss or a profit which is not enough for dividends in a certain year, the dividends to cumulative shares are carried forward to the next year(s) when enough profit are made

-Non- cumulative shares are the ones whose dividends are not carried forward to the following year(s)

2) Debentures

This refers to loans from the public to a company or an acknowledgement of a debt by a company

They carry fixed rate of interest which is payable whether profit are made or not.

They are issued to the public in the same way as shares.

They can be redeemable or irredeemable.

Redeemable debentures are usually secured against the company's assets in which case they termed as *secured debentures or mortgaged debentures.*

Where no security is given, the debentures are called unsecured /naked debentures.

3) Loans from bank and other financial institutions;

A company can borrow long term or short term loans from banks and other money lending institutions such as Industrial and Commercial Development Corporation [I.C.D.C]

These loans are repayable with interest of the agreed rates.

4) Profits ploughed back;

A company may decide to set aside part of the profit made to be used for specified or general purposes instead of sharing out all the profit as dividends.

This money is referred to as a reserve.

5) **Bank overdraft;**

A customer to a bank may make arrangements with the bank to be allowed to withdraw more money than he/she has in the account.

6) **Leasing and renting of property.**

7) **Goods brought on credit.**

8) **Acquiring property through hire purchase**

TYPES OF COMPANIES

i. ***Private Limited company***

Private limited company has the following characteristics;

- Can be formed by a minimum of 2 and a maximum of 50 shareholders, excluding the employees,
- Does not advertise its shares to the public, but sells them privately to specific people
- Restricts transfer of shares i.e. a shareholder cannot sell his/her shares freely without the consent of other shareholders.
- Can be managed by one or two directors. A big private company may however, require a board of directors
- Can start business immediately after receiving the certificate of incorporation without necessarily having to wait for a certificate of trading.
- It does not have an authorized minimum share capital figure.
- Has a separate legal entity and can own property, enter into contracts, sue or be sued.
- Has limited liability.
- Has a perpetual existence.

Formation

-It must have a memorandum of association, article of association list of directors, declaration signed by a director or lawyer and certificate of incorporation.

Advantages of private limited company

i) ***Formation:*** The Company can be formed more easily than a public company. The cost of information is less than that of a public company

ii) ***Legal personality:*** A private company is a separate legal entity from its owners. Like a person, it can own property, sue or be Sued and enter into contacts

iii) ***Limited liability:*** Shareholders have limited liability meaning that they are not responsible for the company's debts beyond the amount due on the shares

iv) ***Capital:*** They have access to a large pool of capital than sole proprietorship or a partnership. They can borrow money more easily from financial institutions because it owns assets which can be pledge as security

v) ***Management:*** A private company has a larger pool of professional managers than a sole proprietorship or a partnership. These managers bring in professional skills in their own areas which are of great advantage to a private company

vi) ***Assured continuity of the business:*** Death, bankrupty or withdrawal of a shareholder does not affect the continuity of the company

vii) ***Trading:*** Unlike a public company a private company can commence trading immediately upon receiving a registration certificate.

Disadvantages of a private company

i) ***Returns:*** A private company, unlike sole proprietorship or a partnership, must submit annual returns on prescribed forms to the registrar of companies immediately after the annual general meeting

ii) ***Capital:*** A private company cannot invite the public to subscribe to its shares like a public limited company

-It therefore limited access to a wide source of capital.

iii) ***Share transfer:*** The law restricts the transfer of shares to its members/shareholders are not free to transfer their shares

ii) Public limited company

Public limited companies have the following characteristics:

a) Can be formed by a minimum of 7(seven) shareholders and no set maximum.
b) Cannot start business before it is issued with a certificate of trading. This is issued after the certificate of incorporation and after the company has raised a minimum amount of capital
c) It's managed by a board of directors.
d) The shares and debentures are freely transferable from one person to another.

e) It advertises its shares to the public/ invites the public to subscribe for/buy its shares and debentures.
f) Must publish their end of year accounts and balance sheets.
g) Must have an authorized minimum share capital figure.
h) Has a separate legal entity and can own property, enter into contracts, sue or be sued.
i) Has limited liability.
j) Has a perpetual existence.

Advantages of public limited company

1. ***Wide range of sources of capital :***It has access to wide range of sources of capital especially through the sale of shares and debentures

-They can also borrow money from financial institutions in large sums and have good security to offer to the lenders.

2. ***Limited liability:*** Like private companies, public limited company's shareholders have limited liability i.e. the shareholders are not liable for the company's debts beyond the shareholders capital contribution.
3. ***Specialized management:*** PLC'S are able to hire qualified and experienced professional staff.
4. ***Wide choice of business opportunities:*** Due to large amount of capital a public company may be suitable for any type of investment
5. ***Share transferability:*** Shares are freely transferable from one person to another and affects neither the company's capital nor its continuity.
6. ***Continuity:*** PLC has a continuous life as it is not affected by the shareholders death, insanity, bankruptcy or transfer of shares
7. ***Economies of scale:*** Their large size enables them to enjoy economies of scale operations. This leads to reduced costs of production which raises the levels of profit
8. ***Employee's motivation:*** They have schemes which enable employees to be part owners of the company which encourages them to work harder in anticipation of higher dividends and growth in the value of the company's shares.
9. ***Share of loss:*** Large membership and the fact that capital is divided into different classes' means that the risk of loss is shared and spread.
10. ***Shareholders are safe guarded;*** Publicity of company accounts safeguard against frauds.

Disadvantages of public limited companies

i) ***High costs of formation:*** The process of registering a public company is expensive and lengthy. Some of the costs of information are legal costs, registration fees and taxes

ii) ***Legal restrictions:*** A public company must comply with many legal requirements making its operations inflexible and rigid

iii) ***Alienation of owners:*** Shareholders non-participation in management is a disadvantage to them

iv) ***Lack of secrecy:*** The public limited companies are required by law to submit annual returns and accounts to the registrar of companies denying the company the benefit of keeping its affairs secret

-They are also required to publish their end of year accounts and balance sheets.

v) Conflicts of interests: Directors may have personal interests that may conflict with those of the company. This may lead to mismanagement

vi) Decision making; Important decision are made by the directors and shareholders. The directors and shareholders meet after long periods which make decision making slow/delayed and expensive

vii) Diseconomies of scale: The large size and nature of business operations of public limited companies may result in high running/operation costs and inefficiency

viii) ***Double taxation:*** There is double taxation since the company is fixed and dividends distributed to the shareholders are also taxed

ix) ***Inflexibility:*** Public limited companies cannot easily change its nature of business in response to the changing circumstances in the market. All shareholders must be consulted and agree.

DISSOLUTION OF A COMPANY

The following are the circumstances that may lead to the dissolution of a company:

- ✓ Failure to commence business within one year- If a company does not commence business within one year from the date of registration, it may be wound up by a court order on application of a member of the company.
- ✓ Insolvency – when a company is not able to pay its debts, it can be declared insolvent and wound up.
- ✓ Ultra- vires – this means a company is acting contrary to what is in its objective clause. In such a case, it may be wound up by a court order.
- ✓ Amalgamation – two or more companies may join up to form one large company completely different from the original ones.
- ✓ Court order – the court of law can order a company to wind up especially following complaints from creditors.
- ✓ Decision by shareholders – the shareholders may decide to dissolve a company in a general meeting.
- ✓ Accomplishment of purpose or expiry of period of operation – a company may be dissolved on accomplishment of its objects, or on expiry of period fixed for its existence.

THE ROLE OF STOCK EXCHANGE AS A MARKET FOR SECURITIES

DEFINATIONS

(1) Stock: a group of shares in a public limited company
  - Stocks are formed when all the authorized shares in a particular category have been issued and fully paid for.

(2) Stock exchange market: is a market where stocks from Quoted companies are bought and sold
  - Stock exchange markets enable share holders in public companies to sell their shares to other people, usually members of the public interested in buying them.

(3) A Quoted Company: is a company that has been registered (listed) as a member of the stock exchange market.
  - Companies that are not quoted cannot have their shares traded in the stock exchange market.

(4) Securities: this could either refer shares or documents used in support of share ownership.

(5) Initial Public Offer (I. P. O): refers to situations in which a company has floated new shares for public subscription (Has advertised new shares and has invited members of the public to buy them.

(6) Secondary market: The market that deals in second hand shares i.e the transfer of shares from one person or organization to another.

There is only one stock exchange market in Kenya i.**e The Nairobi Stock Exchange.**

A person wishing to acquire shares will do so either at an **IPO** or in the **secondary market.** However, an investor cannot buy or sell stocks directly in the stock exchange market. They can only do so through stock brokers.

ROLES OF THE STOCK EXCHANGE MARKET

(1) **Facilitates buying of shares-** it provides a conducive environment to investors who want to buy shares in different companies.
(2) **Facilitates selling of shares-** it creates a market for those who wish to sell their shares.
(3) **Safeguarding investors' interests-** it monitors the performance of the already quoted companies and those found not meeting expectations are struck off. Companies who want to be quoted must also attain a certain standard of performance.
(4) **Provides useful information-** it provides timely, accurate and reliable information to investors which enable them to make decisions on the investments to make. The information is passed on through mass media and stock brokers.
(5) **Assist companies to raise capital-** it assists companies to raise capital by creating an environment through which companies issue new shares to members of the public in an **IPO**.
(6) **Creation of employment-** it creates employment for those who facilitate the buying and selling of shares eg stock brokers, stock agents etc.
(7) **Raising revenue for the government-** the government earns revenue by collecting fees and other levies/ dues from activities carried out in the stock exchange market.

(8) **Availing a variety of securities-** it avails a variety of securities from which an investor can choose from. The market therefore satisfies needs of various investors eg investors who wish to buy from different companies can do so in the market.

(9) **Fixing of prices-** the stock exchange market is in a position to determine the true market value of the securities through the forces of demand and supply. This is of great importance to both the buyer and the seller.

(10)**Measures a country's economic progress-** the performance of securities in the stock exchange market may be an indicator of a country's economic progress e.g a constant rise in prices and volumes of securities traded within a given period of time would indicate that the country's economy is positively growing.

(11)**Promotes the culture of saving-** it provides investors with opportunities to channel their excess funds. Such people act as role models to other members of the society who may emulate them thereby promoting a saving culture.

PUBLIC CORPORATIONS (STATE CORPORATIONS)

These are organizations formed by and/or controlled by the government (the government has a controlling interest). This means that the government owns more than 50% shares in the corporation. Where the government has full ownership, the organization is known as a parastatal

- Public corporations are formed to perform certain/specific functions on behalf of the government.
- They are formed to provide essential services that are generally in the public interest, and that may require heavy initial capital investment which few private investors can afford
- They are formed by the act of parliament.

Examples

- Kenya Railways corporation- provides railway transport
- Telkom Kenya-provides telecommunication services
- Postal corporation of Kenya
- Industrial and commercial Development corporation (ICDC)- financial and management services
- Mumias and Chemelil sugar companies.
- Kenya air ways- provide air transport services. etc

Characteristics/features of public corporations

- They are formed by the government under the existing laws i.e formed by an act of parliament eg education act
- Initial capital is provided by the government.
- They are jointly owned by the government and members of public/private investors.
- They are set up to perform certain specific functions on behalf of the government
- They are managed by a board of directors appointed by the government or appointed by the government and the joint owners.

- They have an entity of their own and can own property, enter contracts, sue and be sued
- They have limited liability
- Some operate without a profit motive while others have a profit motive

Formation

-Some are formed by an act of parliament while others are formed under the existing laws.

-When formed by an act of parliament, the Act defines its status obligations and areas of operation. The Act outlines the following;

- Proposed name of the corporation
- Aims and objectives
- Goods or services to be produced and provided
- Location(Area of operation)
- The appointment of top executives
- The powers of the Board of directors
- The ministry under which it will operate

Management

-The public corporations are managed by a board of directors appointed by the president or the relevant minister.

-The chairman and the board of directors are responsible for the implementation of the aims and objectives of the corporations.

-The chairman of the board of directors reports to the government (president) through the relevant minister.

-The managing director who is usually the secretary of the board of directors in the chief executive officer of the corporation

Sources of capital

-The initial capital is usually provided by the government as a vote of expenditure for the ministry concerned

-Those corporations jointly owned by the government and the public raise capital through the sale of shares

-financial institutions in form of loans

-Retained profits/profits ploughed back.

-Hire purchase.

Advantages of public corporations

- Initial capital is readily available because it is provided by the government
- Can afford to provide goods and services at low prices which would otherwise be expensive if they were left to the private sector.
- Most of them produce goods and services in large quantities thereby reaping the benefits of large scale production
- Some are monopolies. They hence enjoy the benefits of being a monopoly e.g. they do not have to incur costs advertising since there is no competition
- They can be bailed out/assisted by the government when in financial problems
- They have limited liability
- Money for research and development can be made readily available by the government
- Through corporations the government is able to remove foreign domination in the country
- They can afford to hire qualified personnel.

Disadvantages of public corporationsThey are managed by political appointees who may not have the necessary managerial know how.

- When they make losses, they are assisted by the government and this could lead to higher taxation of individuals
- Lack of competition due to monopoly leads to inefficiency and insensitivity to customers feelings.
- Political interference may hamper efficiency in the achievement of set goals and objectives.
- Decision making is slow and difficult because the organizations are large.
- They may lack close supervision because of their large sizes.
- There is embezzlement of large sums of money leading to loss of public funds
- The government is forced to provide goods and services to its citizens in all parts of the country where at times its uneconomical to provide them because the costs of providing them may surpass the returns
- Public funds are wasted by keeping poorly managed public corporations.
- Diseconomies of scale apply in these business units because they are usually very large scale organizations e.g. decision making may take long.

Dissolution of public corporations

They can only be dissolved by the government due to;

1. Persistent loss making
2. Bankruptcy- where the corporation cannot pay its debts.
3. Change in the act of parliament that formed the corporation.
4. Privatization.
5. Mismanagement, resulting in poor management of the corporation.

TRENDS IN FORMS OF BUSINESS UNITS

(1) Globalizations;

This refers to the sharing of worlds resources among all regions i.e where there are no boundaries in business transactions

Some companies referred to as multinationals, have branches in many parts of the world e.g coca-cola company

Globalization has been made possible and effective through the development and improvement of information and technology organization i.e

- **World website (internet);** one can acquire and order for goods through the internet. This is referred to as Electronic Commerce (E- Commerce) and E- Banking.
- **Mobile phones** technology has revolutionized ways of life and business and even remote areas have been opened up.

(2) ***Business Amalgamations/combinations***

This occurs when two independent business enterprises combine to form one large organization

Levels of combinations

i) ***Vertical combination;*** This is when businesses engaged in different but successive levels of production combine e.g. primary(extractive) level combines with secondary(manufacturing)level or secondary level combining with tertiary level.

Example; A company producing cotton (raw materials) combining with a textile industry.

ii) ***Horizontal combination;*** This is where business enterprises of the same level combine e.g. secondary and secondary levels e.t.c

Types of Amalgamation/combination

Amalgamations whether vertical or horizontal can be achieved in these ways;

a) ***Holding companies***

-A holding company is one that acquires 51 percent or more shares in one or more other companies.

-The various companies entering into such a combination are brought under a single control.

-These companies are controlled by the holding company and are called ***Subsidiaries***.

-The subsidiary companies are however allowed to retain their original names and status, but the holding company appoints some members to be on the board of directors of these subsidiaries, so as to control their activities.

-Holding companies are usually financial institutions because they are able to buy controlling shares in subsidiary companies

b) Absorptions (takeovers)

This refers to a business taking over another business by buying all the assets of the other business which then ceases to exist.

Example; Kenya Breweries took over the castle company in Kenya

c) Mergers(Amalgamation);

This is where two or more business organizations combine and form one new business organizations.

-The merging companies cease to exist altogether.

d) Cartels

This is a group of related firms/ companies that agree to work together in order to control output, prices and markets of their products – O. P. E. C (organization of petroleum exporting countries) is an example.

(3) **Privatization**; this is the process of transferring / selling state owned corporations to public limited companies or private investors. This is done by the Government selling their shareholding to members of the public. The main aim is to:
   - **Improve efficiency**
   - Generate revenue for the government.
   - Reduce government control
   - To break monopolistic practices
   - To reduce government expenditure on corporations that relies on government subsidy.

(4) **Check off system**- this is a method of remitting money especially to **SACCOS** where the employer deducts the contribution from the source and submits it to the SACCO on behalf of the employee who is a member of the SACCO.

(5) **Burial Benevolent Funds (B. B. F**); some SACCOS have started systems/ funds to assist their members financially in burials through creation of BBF.
(6) **Front Office Savings Account (FOSA);** SACCOS have expanded their services to members by introducing FOSA. The account enables members to convinientlydeposit and withdraws money. A member may also be provided with an ATM card which enables him/her to withdraw money at various pesa points/ ATM's.
(7) **Franchising ;** this is where one business grants another the rights to manufacture, distribute or produce its branded products using the name of the business that has granted the rights eg General motors' has been granted franchise to deal in Toyota, Isuzu and Nissan vehicles.
(8) **Trusts;** This is where a group of Companies work together to reduce competition. Trusts may also be formed where a company buys more than 50% of shares in a competing company so as to reduce competition.
(9) **Performance contracts;** Employees in state corporations are expected to sign performance contracts in order to improve their efficiency. Other private institutions are also adopting the same practice.