

8. Jasmine and Gary own a high street retro game shop. They sell both video games and board games. They have noticed that fewer people are visiting the store area, and this is affecting their revenue. They are considering investing in an ecommerce website to accompany store sales.
- Explain **one** advantage to Jasmine and Gary of having a virtual store as well as a physical store. [2]
 - The owners have noticed that similar games shops nearby are still busy and think this may be related to price. Explain **one** reason why a business may need to know what price competitors are charging. [2]
 - State **two** disadvantages of online retail to a business. [2]

9. You have taken ownership of a popular mobile car detailing business. You need to attract new customers in order to maintain growth. You are considering a promotional campaign to raise awareness of a new alloy wheel repair service.

Discuss whether you should use social media or radio to advertise the new service.

Your recommendation should include:

- An advantage and a disadvantage of social media
- An advantage and a disadvantage of radio
- A justification for your decision.

[8]

5.1 APPROPRIATE FORMS OF OWNERSHIP FOR BUSINESS START-UPS

When an entrepreneur decides to start up a business, they have a number of different options for its formation. Each option will have an impact on the legal status of the business.

Limited and unlimited liability

If a business owner (entrepreneur) has **unlimited liability**, then they and the business are seen as the same legal entity. This is known as an **unincorporated** business. Any debts that the business has, will be the total responsibility of the owner. If the business cannot pay the debts off, then the owner may have to sell personal possessions to clear them. If an entrepreneur has **limited liability**, then they are seen as separate from the business in the eyes of the law. This is called **incorporation**, where the debts of the business are not regarded as personal debts of the owner. The entrepreneur is only liable for the amount of money that they have personally invested.

Types of ownership

Sole trader Unlimited liability

£ A **single owner** keeps or reinvests all the profits as they wish.

Advantages

- Quick and easy to set up.
- Sole trader makes all the decisions.
- Business' financial information is kept private.

Disadvantages

- Sole trader faces unlimited liability.
- No partners to share the decision making with which can be lonely and stressful.
- May be more difficult to raise finance.
- Business may not run if sole trader is off sick or takes holiday.



FRANCHISING

An entrepreneur has the option to set up as an independent business or set up as a **franchisee**. A **franchisee** is licensed to sell the products or services of an already established business, known as the **franchisor**.

Types of ownership continued

Partnership Unlimited liability

Limited Liability Partnership (LLP) Limited liability

A **partnership** is an unincorporated business which has two or more owners who share the risk. An **LLP** provides protection to each partner from personal liability beyond what they have already personally invested into the business.

Profits are reinvested or shared amongst partners according to agreed ratios.

Advantages

- Each partner could contribute finances, bring ideas and different skills.
- The workload and responsibility for decisions can be shared between partners.
- Business' financial information is kept private.

Disadvantages

- Partners of standard partnerships face unlimited liability.
- There may be disagreements over decision making between the partners.
- An LLP requires a slightly more formal legal set up than a partnership.

Private limited company (ltd) Limited liability

A private limited company is an incorporated business which is owned by **private shareholders**. Shares can only be sold privately, usually to friends and family.

Profits are paid via dividends to shareholders. Directors appointed by the shareholders have full responsibility for decision making and the operation of the business.

Advantages

- Easier to raise finance by selling shares.
- Owners have limited liability.

Disadvantages

- Overall control could be lost.
- The company's accounts and financial information is not private.
- More legal paperwork involved when setting up as it is more complex.

Scott is looking to extend his hobby for fixing garden machinery to accept paid work. He works on his own in his garage. Scott has very few start-up costs and wants to make the transition into business as simple as possible

Discuss which form of ownership would be most suitable for Scott.

Scott has no other partners involved in the business, so a sole trader or limited company are the best options.^[1] Of these, a limited company would require registration and additional paperwork to get started which Scott is hoping to avoid.^[1] Whilst a limited company would protect Scott from being liable for the business' costs, it appears that he won't have many so a sole trader might be most suitable.^[1] A sole trader is also quickest and simplest to set up.^[1]

Franchise

The license given by the franchisor allows the new owner to trade using the name, products and equipment of the franchisor, whilst remaining independent. However, the franchisor will charge a **fee** in return, as well as taking a share of the business' revenues, known as a **royalty**.

Discuss the drawbacks to an owner of setting up a business as a franchisee.

[6]

One drawback is that a franchisee cannot choose where to get supplies from.^[1] This lack of control means that they have no room to shop around to find a cheaper supplier,^[1] meaning that they are unable to reduce their variable cost by finding someone selling supplies for less.^[1] Therefore, they may be unable to change the price that the product is sold for,^[1] which could make them uncompetitive against other local independent competitors.^[1] This could have a negative impact on sales levels,^[1] causing the business not to sell enough products to break even.^[1] Other drawbacks include expensive start-up fees, royalty fees to the franchisor regardless of profits made, the impact of other franchisees affecting your own reputation, and other restrictions placed on the franchisee such as choice of location.

Why start as a franchise?

By setting up as a franchise rather than an independent business, the new owner is hoping to reduce the risks faced when starting a business. Risk is reduced because of the following reasons:

- **Brand name** is already established: This will mean that customers will recognise the business name and its products, so may be more likely to purchase products. The business will already have an established customer base.
- Access to **established products and processes**: Not only will the franchisee be able to sell products that customers already know about, they will also gain access to the franchisor's processes and equipment.
- Franchisor provides **training**: The franchisor will provide ongoing support for the franchisee. This is because it is in their interest that the business is successful too.
- Franchisor undertakes **advertising and promotion**: This means that there is one less thing for franchisee to do. The franchisor can afford to undertake expensive advertising that the individual owner may not be able to pay for if they were completely independent.

The responsibility for decision making in a franchise will belong with the owners and the franchisors jointly.



SOURCES OF CAPITAL FOR BUSINESS START-UPS AND EXPANSION

All businesses need sources of finance to set up the enterprise and for growth.

Internal sources of funding includes retained earnings (profits) and investment from within the enterprise, such as a sole trader's own savings. **External sources** of finance include banks, institutions, individuals and companies outside of the enterprise.

Using your own savings

Advantages

- No interest to pay on your own savings.
- Borrowing from family. Usually no or low interest payable.
- No debt created.
- No application forms to complete.
- Funds are immediately available.

Friends and family may offer financial support as a gift or a loan.

Disadvantages

- If the enterprise fails, the owner loses the money.
- Limited by what savings are available.
- Borrowing from family. May insist the money is paid back at any point or want to be consulted on how the money is spent which could harm the business.



External sources of finance

Loans

(Usually from a bank or building society.)

Advantages

- The interest rate is usually fixed for the entire loan period.
 - Easy to budget for if it is a fixed repayment every month.
 - Loan interest is generally lower than other sources of finance.
 - Can borrow large sums.
 - Lender gets no business shares.
- #### Disadvantages
- Interest rates, fees or bank charges may apply.
 - Failure to repay the loan may lead to bankruptcy and repossession of assets.
 - Bank may want security (e.g. a fixed asset) to loan against.
 - Time consuming application forms are required.

Business angel investment

Advantages

- Can also provide a source of advice and support.
- Do not have to pay interest or repayments.

Disadvantages

- May involve allowing them to make management decisions and/or giving them a share of the enterprise.

Crowdfunding

Advantages

- Quick way to raise finance with no fees.
- Alternative source if businesses struggle to get bank loans / are higher risk.
- Can test the reaction of the market to new ideas.
- Large sums can be raised.
- No security is required.

Disadvantages

- If you don't reach the funding target, money is returned to the investors.
- If you don't own copyright or a patent someone can steal your idea.
- Need to invest time and money to launch the project.

Grants

Advantages

- Grants do not always need paying back.
- Often free of interest and fees.

Disadvantages

- Only certain types of businesses are eligible.
- May be conditions attached to them which have to be fulfilled.
- Hard to get if limited funds are available for many businesses.



SUPPORT FOR ENTERPRISE

Many organisations and services are set up for businesses to use where they need support. They may provide specialist services or more general advice where entrepreneurs need it most.

	Advantages	Limitations
Finance providers, e.g. bank, business angel	<ul style="list-style-type: none"> Provide finance for start-ups or expansion. Can provide good advice to accompany the finance. 	<ul style="list-style-type: none"> Need to repay interest or part with a share in the business.
Local council enterprise department	<ul style="list-style-type: none"> Likely to understand the local economy you operate in. Can offer free advice to support SME growth. 	<ul style="list-style-type: none"> May not understand your own niche business. May not be immediately available for advice or may provide a report weeks later.
Accountants	<ul style="list-style-type: none"> Qualified, impartial advice. Up to date advice. Can save businesses far more than the fees they charge. 	<ul style="list-style-type: none"> Expensive. Their financial advice may not be right for your business.
Solicitors	<ul style="list-style-type: none"> Qualified professionals with trustworthy, confidential advice. Up to date advice. Unbiased advice. 	<ul style="list-style-type: none"> Expensive. Need a solicitor experienced in a specific legal area. A good solicitor may not be immediately available.
Friends and family	<ul style="list-style-type: none"> Usually free Usually available immediately 	<ul style="list-style-type: none"> Heavily biased. May be unqualified to advise.
Chamber of Commerce (A network of business support organisations)	<ul style="list-style-type: none"> Offer specialised support to growing businesses. Can be a useful place to meet other entrepreneurs and share problems. 	<ul style="list-style-type: none"> Membership fees are required. Regular meetings may not always be convenient or useful.
Government	<ul style="list-style-type: none"> Valuable financial, emotional and technical support for first-time entrepreneurs. Mentors and training available from some government divisions. 	<ul style="list-style-type: none"> Information overload means it isn't always clear what the right path is.
Charities	<ul style="list-style-type: none"> Financial support and training offered. Information and impartial advice. 	<ul style="list-style-type: none"> Limited in what they can provide owing to funding. Often specific on who they will/can support.

EXAMINATION PRACTICE

1. Amy makes and sells jewellery by herself. She wants to invest in new machinery through the use of a loan.

Which **one** of the following ownerships structures should Amy use to avoid personal liability for the investment loan should the company not succeed? [1]

- A. Limited liability partnership.
 B. Partnership.
 C. Private limited company.
 D. Sole trader.

2. Which **one** of the following is an advantage of running a business as a sole trader? [1]

- A. Can keep all of the profits.
 B. Company accounts are publicly available.
 C. Easier to raise finance.
 D. Unlimited liability.

3. Which **one** of the following is an advantage of accepting investment funds from a helpful friend? [1]

- A. Formal application forms are not necessary.
 B. Friend may insist in being consulted on how the funds are spent.
 C. Friend may need the money back sooner than expected.
 D. The investment may be lost which may damage the friendship.

4. Explain what is meant by 'unlimited liability'. [2]

5. Polly is considering opening an optician either as a franchise or as a sole trader.

Analyse **two** advantages of franchise ownership compared with a sole trader. [6]

6. You are the sole shareholder of a limited business that has been offered investment for a new project by an angel investor and has an agreement in principle on a bank loan.

(a) Discuss which of the options would be best for the business and provide a recommendation.

Your recommendation should include:

- An advantage and a disadvantage of angel investment
- An advantage and a disadvantage of a bank loan
- A justification for your decision.

(b) Suggest **two** alternative sources of investment that do not usually involve interest or fees. [2]

7. You need advice from an accountant about new laws surrounding taxation and profits within your industry.

Explain **one** benefit and **one** limitation of seeking advice from an accountant. [4]