WHAT IS A PRIVATE LIMITED COMPANY?

CONTENTS
What is a limited company?
ACTIVITY 1.9.1 Types of organisation
What is a private limited company?
Advantages of being a private limited company
Disadvantages of operating as a private limited company
What is a limited company?

A limited company is a type of legal business organisation where ownership and control are in the hands of different people. The owners of the company are called shareholders or members. They receive share certificates in return for the capital they have invested. The actual management of the business is the responsibility of company directors. Directors are not necessarily shareholders.

Lawyers describe companies as incorporated businesses. In law, companies are separate legal persons. Technically, the company has a different legal identity from either shareholders or directors. Employees of a company are employed by the company. Debts are owed or owing to the company. Sole traders and partnerships, on the other hand, are described as unincorporated businesses. An unincorporated business has no separate legal identity.

In a company, shareholders have limited liability for debts. In the event of business failure, creditors are only entitled to recover money equivalent to the total original value of shares. (This is not the same as the current market value of the shares.)

Suppose a start-up business issues shares totalling £100,000. Each share costs £1. The shareholders know that the most the company will normally be required to pay out for unpaid debts in the event of business failure is £100,000. This applies even if the total owed is far more than £100,000. Significantly, the debts belong to the company, not the shareholders. Each shareholder stands to lose an amount equivalent to the value of the shares they hold, but no more than that. So if X has shares with a stated value of £1000 (1000 shares), he or she will only be risking £1000 and need not be affected beyond that if the company collapses with debts much greater than the original share capital. Shareholders may lose what they paid for their shares, but their personal assets, such as their houses, are not usually at risk. The creditors of the company will have to bear the brunt of the financial risk.

You might be wondering how people benefit from buying share certificates. The answer is that shareholders stand to gain in two ways. Firstly, they are eligible to receive a share of any profits. That share corresponds to the proportion of company shares they hold. Profits distributed in this way are called share dividends. Secondly, if the company grows and does well, shareholders may see an increase in the market value of the shares they hold. In other words, the second-hand value of a share may well be greater than its original purchase price.

Now try the activity on types of organisation on the next page.
ACTIVITY 1.9.1  Types of organisation

TASK
Identify whether the following sentences are true or false.

1. A partnership has more access to finance than a sole trader.
2. Being a sole trader means that only one person works in a business.
3. A sole trader has complete control of the business.
4. A partner has unlimited liability for debts.
5. If a sole trader runs into serious financial trouble creditors are able to demand that all assets should be seized to pay for debts, not just business assets.
6. Limited companies can also be described as unincorporated businesses.
7. Partners divide profit between themselves as dividends.
8. Company directors can be shareholders.
9. Shareholders have responsibility for the management of a company.
10. The relationship between shareholders and directors is set out in a partnership agreement.
What is a private limited company?

Private limited companies have “Ltd.” after the company name (e.g. Evans Double Glazing Ltd.) In a private limited company, shareholders cannot sell their shares to someone else without the agreement of the other shareholders. The ownership of the business is a private matter between those concerned. Shares in private limited companies are not sold on the Stock Market. Private limited companies are typically small to medium sized businesses, although there is no reason why a very large business company should not be a private one. (An example of a very large private company is John Lewis, which owns Waitrose supermarkets and John Lewis department stores.)

As mentioned earlier, company directors are responsible for the management of the business. There may be different levels of management within the workforce of the company, but directors will be the most senior level. In a private limited company it may be that shareholders and directors are largely the same people. Small family run companies may seem not much different from a partnership, because the family members involved are both directors and shareholders.

On the other hand, there is nothing to stop a private limited company from allowing an outside investor or investors bringing capital into the business by buying shares. This is a way of keeping ownership and control of a company quite separate. However, shareholders do have influence over really big decisions when the company’s annual general meeting (agm) is held. At this meeting the annual company accounts will be examined and the overall performance and future direction of the business considered. The directors’ plans for the future of a business may be blocked if shareholders fail to approve them in a vote. Votes are held in proportion to the number of shares held. Any shareholder or group of shareholders who have more than 50% of the shares will obviously have most power at a general meeting.

Advantages of being a private limited company

Compared to an unincorporated business (sole trader or partnership) a private limited company represents a clever means of attracting investment capital to start the business with. Entrepreneurs have the chance to persuade other people to put their money in, in return for shares. This is the attraction of limited liability. There are more ways of raising finance.

The most that shareholders can lose is what they spent on their shares. In contrast, someone who becomes a partner in a partnership without being actively involved in the running of the partnership
might well have sleepless nights thinking about what he or she stands to lose if the business fails. (If you do not understand what this means, re-read the section on the disadvantages of being a sole trader above.)

In a private company, shareholders accept that their money is tied up in the business for the long term. This is not something that can be said of a bank loan. If the bank providing finance decides that a business is performing badly, it may suddenly demand repayment.

**Disadvantages of operating as a private limited company**

The separation between management and ownership can cause conflict. After all, shareholders do have influence on major decisions within the company. Company directors have to keep shareholders happy to some extent, and they may feel that this is not always in the long-term interests of the business. For example, shareholders may expect dividends to be paid to them by the company, when directors would rather plough profits back into the business.

To create a company, the business has to be registered with a government office called the Registrar of Companies. This involves drawing up legal documents. Although it need not cost much to register a company, the requirement to comply with the terms of these legal documents and various other rules affecting companies involves an on-going administrative burden for a small company.

Not only do companies have to produce more complicated accounts, but also their accounts are open to scrutiny by the public. An incorporated business is less able to keep its affairs private.

Banks and other creditors will be aware of the risk they run of losing money when dealing with a company (through the concept of limited liability.) So in practice they may require directors to provide a personal guarantee that loans will be repaid in full if required. Where such a guarantee is given, the concept of limited liability becomes rather irrelevant.