5 Company types and corporate governance

Company types

In law, there are various types of business entity. For each one there are different legal arrangements to register the company, different requirements for presenting accounts, etc. The main business types are:

Sole trader (UK) / Sole proprietorship (US)
A single person owns and operates a business. Legally, the business has no separate existence from its owner (proprietor). This means that all the debts of the business are the debts of the owner.

Partnership (UK and US)
Two or more people work together and share the risks and profits. Just like a sole proprietor, the partners are fully liable for (= responsible for) any debts the business has. This is referred to in law as 'unlimited liability'.

Company (US and UK) / Corporation (US)
The business is a legal entity that is separate from its owners – the shareholders. The owners are not fully liable for the debts of the business. Instead, their liability (= potential risk) is restricted to their share capital. This is the amount of cash that they have contributed to the company. This is referred to in law as 'limited liability'.

There are two main types of companies:

- Private company: the shares (AmE stocks) are private in the sense that they cannot be bought by members of the public. The vast majority of companies fall into this category. They're often smaller companies, with shares held by a few business associates or family members.
- Public company: the shares are openly traded on a public stock exchange. These are the large, often well-known businesses. The word 'public' should not be confused with 'state-owned'. A 'state-owned enterprise' (SOE) is owned by the government.

The Board

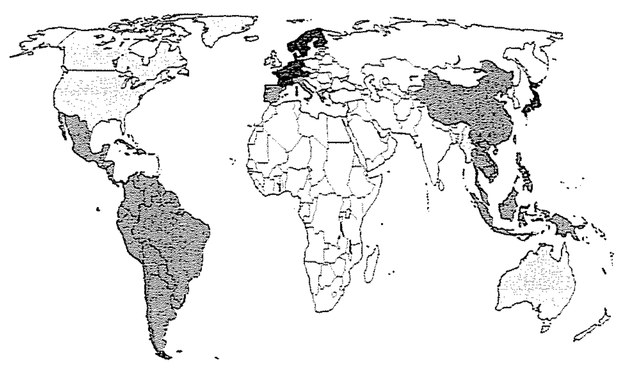
Public companies are controlled by a board of directors ('the Board'), elected by the shareholders. Not all Boards are fully independent, but in general their role is to:

- Set long-term strategy.
- Appoint a Chief Executive Officer (CEO) and other members of the senior management team to run the company day-to-day.
- Ask questions about any short- or medium-term strategy developed by the CEO, and then support it once they have agreed.
- Oversee the preparation of the financial statements.
- Appoint and ensure the independence of the company's auditors.
- Oversee and manage risk.
- Set an annual dividend.

Who chooses the Board? In theory, it's the shareholders. At the Annual General Meeting (AmE Annual Meeting of Stockholders) the shareholders can question Board members, vote to accept or reject the dividend, vote on replacements for retiring Board members, etc. But, in practice, the situatic may be different. In particular, most shares are held by larg institutions, and these may simply sell their stake if they aren't happy, instead of trying to change the Board.
In reality many Board members are chosen by the CEO and the shareholders simply approve these members.

Corporate governance

This whole issue of the role of the Board, how senior managers are responsible to shareholders, and how the company is run, is referred to as 'corporate governance'. Traditionally, different regions of the world have had different models of corporate governance.



Anglo-American model: separation of ownership (ie shareholders) and control (ie managers); priority given to the interests of shareholder.

European / Japanese model: similar to the Anglo-American model, but a greater recognition of the interests of other stakeholders such as employees, suppliers, customers, lenders (eg banks), and the community.

East Asian / Latin model: family-owned companies with no independent Board or outside shareholders.

Nowadays this traditional pattern is breaking down, and the situation is more mixed. However, the following basic principles of corporate governance are widely accepted:

- Respect for the rights of shareholders.
- A clear definition of the roles and responsibilities of Boar members.
- Integrity and ethical behaviour.
- Disclosure (= giving full information) and transparency.

Exercises

5.1 Underline the correct words in italics.

1 Money that a person or company owes is *debt / liability*. The word *debts / liabilities*, when used in the plural and in a formal context, has the same meaning – but it can also have a wider meaning of 'legal responsibilities'.
2 The word *owner / proprietor* means that you legally have something – anything. The word *owner / proprietor* means that you have a business (and is more formal).
3 If you and your business partners all have the same risks at the same time, then you *divide / share* the risks. If you separate the risks into smaller parts or different categories, then you *divide / share* them (= split them).
4 A *shareholder / stakeholder / stockholder* is someone who owns part of a business, in British English. A *shareholder / stakeholder / stockholder* is the same, in American English. A *shareholder / stakeholder / stockholder* is anyone who has an interest in the success of a plan, system or organization.
5 If you're a shareholder in a company, then every year you receive *an income / a profit / a dividend* paid out of the company's *income / profits / dividends*.

5.2 Read the definition below and find the word in the text. (It appears twice.)

(formal) 'a general term for any institution, company, partnership, government agency, or any other organization which exists in law as a separate and complete unit.'

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5.3 Fill in the missing letters.

1 If you're completely liable for something, then you're f_ _ _y liable.
2 If you're liable for something in law, then you're le_ _lly liable.
3 If you as an individual are liable for something, then you're per_ _ _ally liable.
4 If you may be liable for something, then you're pot_ _ _ially liable.
5 If you keep shares for a long time, then you h_ _ _ them.
6 If you buy and sell shares, then you tr_ _ _ them.

5.4 Find a word in 'The Board' section opposite that matches each definition below.

1 watch the progress of something to make sure it's done correctly; supervise ________________
2 external firms that officially examine the financial records of a company to see that they're true and correct ________________
3 an amount of the profits that the company pays to shareholders ________________
4 money invested in a business ________________

Now do the same for the 'Corporate governance' section.

5 the quality of being honest and having high moral standards ________________
6 doing things in a way that allows other people to know exactly what you're doing ________________

5.5 Make word partnerships by matching one item from each box. Then use the word partnerships to complete the text below.

detailed *legal* *limited* *non-profit*

entity *legislation* *liability* *organization*

The letters that follow a company name can tell you about its status in law.

In the UK, a private company has 'Ltd' after its name (because of the 1 ________________ of its owners) and a public company has PLC (standing for Public Limited Company).

In the US, 'LLC' (Limited Liability Company) and 'Corp' are approximate equivalents to 'Ltd' and 'PLC', although the 2 ________________ governing company formation is different in the two countries.

The letters 'Inc' (meaning 'incorporated') are also used in the US, and they cover a very broad range of organizations. They can refer to any 3 ________________ that is separate from its owners such as a private company, a public company, a 4 ________________, or a sports club.

5.6 Cover everything on these two pages with a piece of paper. Write down the full form of these abbreviations: *CEO, AGM, PLC, LLC*.

See page 146 for some discussion topics.

"All in favor of a cap on our liability?"