

Types of Business Entities

IB exam-prep notes (AO1/AO2/AO3). Based on the provided text. Date: 27 Feb 2026.

1. Big picture: why businesses change legal form

To stay competitive, businesses often need to change how they operate. One major type of change is changing legal form (e.g., sole trader → company) to access finance, reduce risk, or expand into new markets.

- Change drivers: technology, consumer demand shifts, competition.
- Creative planning: can unlock growth (e.g., restructuring to raise capital).
- Ethics: ethical behaviour can improve reputation and customer loyalty.
- Sustainability: reducing pollution/using renewables can lower opposition and improve long-term survival.

2. Public and private sectors (AO2)

Sector	Ownership	Typical objectives	Examples
Private sector	Owned by private individuals/shareholders.	Profit + growth (often CSR).	Software firms, cafés, construction firms, car dealerships.
Public sector	Owned and operated by government.	Social objectives; service provision; reinvest surplus.	Postal services, public universities, state healthcare.

Key terms (AO1)

- Nationalization: government takes control/ownership of a private business.
- Privatization: government transfers ownership of a state-owned organization to private investors.
- Merit goods: services with wider social benefits that may be under-consumed without government involvement (e.g., vaccinations, schooling).

2.1 Reasons for government ownership (AO2/AO3)

- Strategic/security reasons (e.g., defence, emergency services).
- Ensure access to essentials regardless of income (e.g., water, energy, healthcare).
- Provide/subsidize merit goods to increase consumption and social welfare.
- Provide socially necessary but unprofitable services (e.g., rural transport links).
- Surplus typically reinvested into service improvement, not paid to owners.

2.2 Changing importance of sectors (AO3)

- The size of the public vs private sector varies by country and can shift over time.
- Political views influence intervention: some economies rely more on planning/state ownership, others on market forces.
- Policies may change due to economic instability, inequality concerns, or shifts in political priorities.

3. Business legal structures: what the choice affects

Legal structure shapes long-term outcomes: control, profit distribution, risk/liability, and access to finance. It affects how easily a business can grow and raise capital.

Structure	Control	Liability	Access to finance	Typical use
Sole trader	Owner only	Unlimited	Limited (savings/loans)	Very small firms; personal services
Partnership	Shared	Often unlimited (shared)	Medium (more than sole trader)	Professional services; shared expertise
Company	Shareholders/directors	Limited	Higher (sell shares, borrow)	Growth and larger-scale operations
Cooperative	Members (1 member = 1 vote)	Varies (often limited)	Often limited (less external equity)	Member-benefit enterprises

4. Sole traders (AO3)

Definition: a business owned and managed by one person. The owner may employ others, but retains full legal responsibility.

Skills and attributes

- Independence and confidence to make decisions alone.
- Versatility: marketing, purchasing, customer service, record-keeping, supplier negotiation.
- Self-discipline and motivation (no external supervision).
- Stress management; long hours especially early on.

Advantages vs disadvantages

Advantages	Disadvantages / risks
Easy to set up; few formalities.	Limited access to finance; higher borrowing costs due to perceived risk.
Full control; quick decisions; flexibility.	Workload heavy; time off reduces income; possible isolation.
Keeps all profits; strong personal satisfaction.	Unlimited liability (personal assets at risk if debts occur).

5. Partnerships (AO3)

Definition: two or more people jointly own and operate a business.

Why partnerships can work well

- Better decisions through shared discussion and problem-solving.
- More capital (each partner can invest).
- Specialisation: different partners contribute different skills (e.g., content, analytics, client management).

- Continuity: partners cover each other during illness/holidays.

Key risks/challenges

- Disagreements can slow decisions and harm relationships.
- Shared responsibility: one partner's actions can damage all partners.
- Often unlimited liability (personal assets exposed).

Partnership agreement (deed)

- Sets rules on profit sharing, dispute resolution, roles, and what happens if a partner leaves.
- Reduces uncertainty and conflict; prevents default equal split if a different arrangement is intended.

6. Companies (private sector companies)

Incorporation: formal process of registering a company so it becomes a separate legal entity. The company can own assets and is responsible for its own debts.

6.1 Ownership and limited liability (AO2)

- Owned by shareholders. Ownership is divided into shares (each share = fraction of ownership).
- Limited liability: shareholders can lose the value of shares purchased, but personal assets are protected from company debts.
- Limited liability encourages investment and makes raising finance through shares feasible.

6.2 Investor returns and power (AO2)

- Dividends: payments from profits to shareholders (not guaranteed).
- Capital gain: share price rises, allowing sale at a profit.
- Voting rights often linked to shareholding (commonly 1 share = 1 vote).
- Majority ownership (>50%) typically provides control over decisions and policy.

6.3 Accountability and transparency (AO3)

- Companies often face more regulation and disclosure (accounts may be audited and publicly available).
- Trade-off: improved access to finance and limited liability vs higher costs and reduced privacy.

Shareholders vs stakeholders (AO1)

Shareholders	Stakeholders
Own shares and are part-owners; seek returns.	Any group affected by business actions (employees, customers, suppliers, community).
Voting rights; may receive dividends.	Influence via contracts, pressure groups, regulation, or reputation effects.
Always stakeholders.	Not always shareholders.

7. Public sector companies and public-private partnerships (AO3)

- Some companies are fully government-owned or majority state-owned and may balance financial performance with wider social/economic responsibilities.
- Public-private partnership (PPP): government + private firm collaborate on major projects (e.g., airports, metro systems). Private partner provides capital/expertise; government may provide guarantees or user charges.

8. Privately held vs publicly held companies (AO3)

Type	Share transfer	Finance implications	Key issues
Privately held company	Share sales restricted; shares not traded publicly.	More limited capital raising; owners retain control.	Lower risk of hostile takeover; less liquidity for shareholders.
Publicly held company	Shares freely traded; anyone can buy.	Can raise large amounts from many investors.	Takeover risk; ownership can change quickly; more scrutiny.

Investor choices: dividends vs share prices

- Returns come from dividends and/or share price growth.
- Dividends depend on firm performance and the wider economy; during downturns firms may cut/suspend dividends to conserve cash.
- Investors consider profitability, growth potential, market conditions, industry risks, and the overall economy.

Important distinction

Publicly held companies are usually part of the private sector. The public sector refers to government-owned/controlled organizations.

9. Changing legal structure (growth pathway)

- As firms grow, it's common to move from sole trader → company to gain limited liability and raise finance.
- Some companies later become publicly held to access larger finance sources via stock markets.
- Trade-off: more funding vs higher regulation, transparency, and legal/accounting costs.

10. Social enterprises, cooperatives, NGOs and charities

10.1 For-profit social enterprises

- Operate as businesses but aim to create social/environmental outcomes.
- Reinvest a significant share of profits into mission projects (jobs, education, fair trade, conservation).
- Ethical reputation can attract customers and employees.

10.2 Cooperatives (co-ops) (AO3)

Definition: a business owned and democratically controlled by its members. Each member has one vote, regardless of investment size.

- Surplus is shared among members or reinvested to improve member benefits; ownership rights are usually not sold for personal gain when leaving.
- Co-ops can strengthen bargaining power and allow resource pooling.

Forms of cooperatives (AO2)

- Employee-owned: workers jointly own; can raise motivation but slow decisions; hard to raise funds from external investors.
- Community: set up to meet local needs (grocery store, broadband, renewable energy).
- Retail: independent retailers collaborate under a shared brand; bulk buying and shared marketing.

10.3 Non-profit social enterprises: NGOs and charities (AO3)

- Non-profit: any surplus is reinvested into social aims (not distributed to owners).
- NGO: independent non-profit operating separately from government; may receive funding from donors, corporations, or public institutions.
- Lobbying: NGOs influence decision-makers using evidence, campaigns, petitions, public awareness, and advocacy.
- Charities: non-profits focused on a cause; funded through donations, grants, events, and sometimes sales.

Online non-profit organizations (AO3)

- Digital platforms can scale rapidly via volunteers and donations.
- Potential issues: accuracy/consistency/reliability challenges, especially with anonymous contributors.

11. Exam toolkit

11.1 Key definitions (AO1)

- Private sector: owned by private individuals/shareholders.
- Public sector: owned/controlled by government.
- Nationalization / privatization: transfer of ownership between sectors.
- Unlimited liability: owners personally responsible for debts.
- Limited liability: risk limited to invested amount.
- Shareholder: part-owner via shares; stakeholder: affected group.

- Cooperative: member-owned; 1 member = 1 vote.
- NGO: independent non-profit lobbying for social/political goals.

11.2 10-mark recommendation structure (AO3)

- 1) Identify context (size, risk, growth ambition, finance needs).
- 2) Compare at least two legal forms using: liability, control, finance, continuity, regulation/costs, ethics/mission.
- 3) Make a justified recommendation with clear judgement.