

# Building the legal framework to help business succeed



## About ACCA

**ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants, offering business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.**

ACCA supports its **219,000** members and **527,000** students (including affiliates) in **179** countries, helping them to develop successful careers in accounting and business, with the skills required by employers. ACCA works through a network of **110** offices and centres and **7,571** Approved Employers worldwide, and **328** approved learning providers who provide high standards of learning and development.

Through its public interest remit, ACCA promotes appropriate regulation of accounting and conducts relevant research to ensure accountancy continues to grow in reputation and influence.

ACCA has introduced major innovations to its flagship qualification to ensure its members and future members continue to be the most valued, up to date and sought-after accountancy professionals globally.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability.

**More information is here: [www.accaglobal.com](http://www.accaglobal.com)**

# Building the legal framework to help business succeed

---

## About this report

Business activities are an essential part of every society. Their success, especially when first starting up, depends on many social and economic variables, but one of the most important (but perhaps frequently overlooked) factors is the legal form the business adopts. Government has several roles to play, the most fundamental of which is to make the forms available, although educating people about them is every bit as vital to effective exploitation of those opportunities, as is ensuring that the support mechanisms are available to help make the most of them.



The background of the page is a light blue sky with three white clouds. In the upper left, there is a red-outlined square. In the center, a man in a dark blue suit and white shirt is running across a gap between two dark blue puzzle pieces. He is carrying a large red puzzle piece. The puzzle pieces are shaped like interlocking puzzle pieces, with the gap between them forming a semi-circular arch. The overall theme is business and entrepreneurship.

# Introduction

**Although doing business is a fundamental part of society, getting started can often be very risky for entrepreneurs. The challenges facing the entrepreneur are not just about choosing the right form, but about exploiting it properly and making the most of its characteristics.**

Government has several roles to play in helping new business get off the ground. Most fundamentally, and uniquely, it is part of government's role to make the legal forms available through legislation. Government alone can set the boundaries of permissible activities under the law, and adjust the rights and obligations of businesses and their stakeholders.

But beyond this, there can be a role for government in educating people about the available options, and helping them to make the most of them. Many jurisdictions offer community interest vehicles or structures designed to promote employee ownership and engagement, but take-up of them can often be low. This may be because entrepreneurs and their advisers are unaware of them, or the latter are unfamiliar with the benefits and so unwilling to promote them (Nuttall 2012: para 3.6). Once businesses are aware of the options, the availability of mentoring schemes, trade networks and grants can significantly improve the chances of a long and successful life for the venture.

Another aspect of business success that governments are uniquely positioned to create is building the trust relationship environment in which business and commerce can flourish.

Ensuring that appropriate models and support are available can drive a more successful and sustainable society for all. For instance, improving the environment for businesses has a clear direct benefit to government, which is a significant buyer of services from private business. The more successful businesses there are in the marketplace then the greater the choice that government will have. Businesses that are run efficiently and effectively through the appropriate structure will be able to supply services to government at a lower price to the taxpayer. Furthermore, there is a benefit from cooperatives and society-driven enterprises because they reduce the need for direct government funding to the extent that they complement or replace public interest activities that would otherwise either not exist or have to be supplied by public bodies. In addition to the benefit to the immediate recipients of such business's activities, society as a whole benefits from the reduced need for direct government funding.

It is vital for governments to consider the local context when looking at the availability of legal forms for businesses. In many jurisdictions, what is really needed is not so much a vehicle for entrepreneurs as a mechanism for equalising bargaining power in the marketplace. Where this is the case, the important design features will not be those governing distribution of the profits (indeed in many cases such organisations are designed not to return profits at all) but rather the regulation of external relationships with customers and suppliers. Close behind that in importance comes the regulation of internal relationships, although if the powers of the body are limited then this also becomes less important. For example, a farming cooperative whose sole function is to purchase seed, fertiliser and machinery, then to sell the output at market, will not have the discretion to

diversify investments, commission expensive marketing campaigns or undertake speculative research and design work. Accordingly, the membership will not need complex mechanisms for reviewing or reversing management decisions to the same extent applicable for a general trading company which might pursue any of those activities.

Another aspect of business success that governments are uniquely positioned to create is building the trust relationship environment in which business and commerce can flourish. Business is basically about trust. Every transaction, every contract, is about promises made between individuals. Sometimes performance is instant, but at other times the performance will be at some point in the future. The parties need to believe and understand that the promises will be kept, or that if one side does try to default then that there will be some way of enforcing the performance or being compensated for the failure.

Government is responsible for developing and maintaining much of the infrastructure, such as the courts and central public registers of business information, that supports those trust mechanisms. As with every other area of business, developments in technology present both threats and opportunities in this sector. Electronic transmission and recording of information reduces the costs of both business and regulators. Online registers can be searched quickly from anywhere in the world, but of course require initial set-up and creation. It is vital that policymakers consider the environment within which businesses operate as well as the way in which they are allowed to do so.

The rest of this report looks in more detail at the specific features of legal business forms and explores the elements that policymakers should consider.

**FIGURE 1:** Five enabling strategies for governments to consider as it approaches each theme



# A framework for designing business forms

In order to help structure this analysis, the characteristics of business forms have been split into four broad categories, considering in turn:



**Realising the returns**



**Investing into the business**



**Legal characteristics**



**Administrative requirements.**

There is inevitably some overlap and interaction between those broad headings, and a number of further considerations must be taken into account. Aspects such as transparency and accountability are increasingly important to stakeholders, while the regulatory mechanisms enabling businesses to operate, and perhaps as importantly, imposing sanctions on those who would seek to operate outside the rules, are a vital component of the functioning system.



# Realising the returns



**Most businesses are run with a view to creating a profit for the investors (whether owners, managers or lenders), but there can be other motivations, such as providing community services or wider public benefits, existing alongside or to the exclusion of the profit motive.**

The purpose of the business might restrict the range of business vehicles available. The long-term goal might be financial security for the founder and their family or partners, or it could be to maximise profitability with a view to sale.

Establishing what form 'value' takes for the business, and then deciding how best to ensure that the value ends up where it is supposed to be, is perhaps the most important consideration for the founders. The choice they make from the available forms will be driven by their approach to achieving their goals, and any compromises they may be prepared to make along the way. It is the job of policymakers to ensure that the range of forms available minimises the compromises required across the population as a whole, without incurring avoidable administrative costs.

Some structures favour regular extraction of accrued profits; others allow for the sale of a share, and future returns on that share, to a third party. A number of cooperative and charitable forms, by

contrast, deliver their value entirely in the form of returns to society or indirectly to the members, and do not allow for any cumulative return to members on capital invested. A system of business forms that responds to these various aims is essential. Designing it will depend on understanding the needs of founders and determining how the outcomes desired can best be reflected by the forms available.

Government policy, as expressed in legislative and regulatory regimes, may reflect an implicit assumption that businesses, especially incorporated ones, exist for commercial gain. This would be evidenced by the emphasis on maintenance of capital, and the widespread existence of specific rules to enhance directors' and owners' personal liability when close to insolvency (Gerner-Beuerle et al. 2013). It will be worth bearing in mind that over two-thirds of respondents to an ACCA survey believe that business legal forms should exist that explicitly recognise that non-financial aims are part of measuring the success of a small business (see Sources and

**68%**  
of aspiring entrepreneurs want Non-Financial Goals to be recognised

Methodology at the end of this report). Nearly 80% of respondents rejected the idea that such entities should be more tightly regulated than others, although they were evenly split between regulation being the same (39%) or less strict (37%) than for purely commercial enterprises.

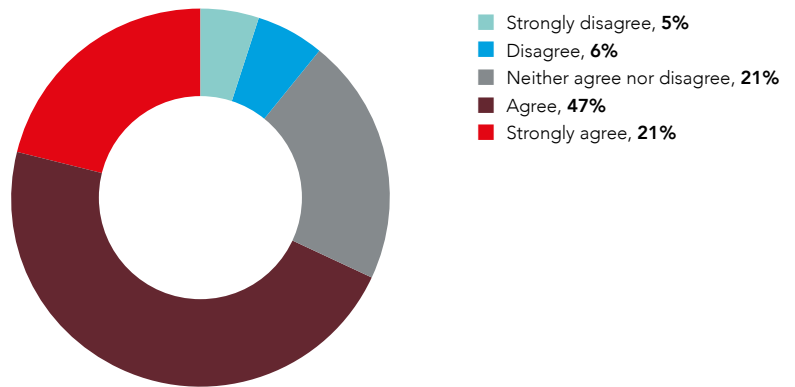
It will be important to address the clear appetite of entrepreneurs for pursuing more than simple financial gain through their businesses. Policymakers should investigate whether existing vehicles offer sufficient flexibility within a single template, or if there are alternatives designed for specifically commercial or non-commercial aims. If neither is the case, then government should consult with the relevant stakeholders to develop the most appropriate local models.

The domestic social and economic environment can play a significant role in shaping the vehicles needed to enable economic activity. In several of the

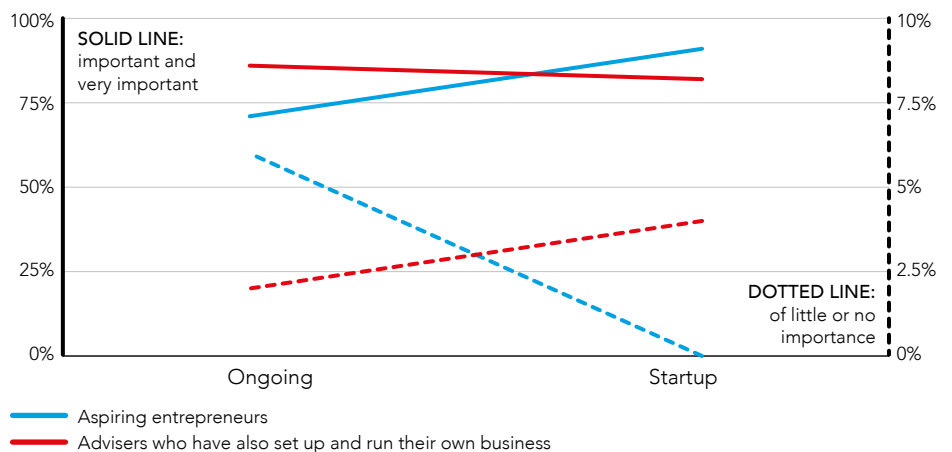
markets surveyed as part of the initial desktop research for this series of reports, farming and business cooperatives exist as a significant and important part of the economic infrastructure. While the adoption of the cooperative form is driven by financial imperatives, the goal is not so much a financial profit as simply allowing access to marketplaces in the first instance. The collective bargaining power of the cooperatives enables those involved to negotiate commercial deals with counterparties on terms that would not otherwise be possible, and while a direct individual financial return on the membership share is typically not available, the members benefit indirectly through being able to deal on those terms in respect of their own transactions (Sabir et al. 2012; Trebbin and Hassler 2012).

Whenever money is realised there are likely to be tax consequences. While it is rarely, if ever, a good idea to allow the choice of business form to be driven exclusively by

**FIGURE 2:** Business Forms should exist which explicitly recognise non-financial goals



**FIGURE 3:** Relative importance attached to startup vs ongoing costs





**It is notable that every group considered that some tax incentives should be offered, with only a handful of respondents actually classing them as 'unimportant'.**

tax, it is nonetheless a factor which must be considered. As shown below, there was a strong preference across all groups surveyed for governments to use the tax system to support small businesses, through mechanisms such as reduced tax burdens on profits, or exemption from specific charges.

The group looking to set up their first business were most in favour of tax incentives, with 45% believing that tax measures should be the primary incentive for small businesses, compared with just 30% of those who have already set up a business, and only 18% of advisers who have set up their own business. While not directly explored in the survey, it is quite possible that the comparatively low importance attached to tax incentives by those who have run their own business is just relative: they simply give other factors more weight, rather than regarding tax as unimportant. In fact, it is notable that every group considered that some tax incentives should be offered, with only a handful of respondents actually classing them as 'unimportant'.

But, however much importance entrepreneurs attach to tax incentives as a concept, their actual importance is more open to question. The vast majority of business taxes suffered by small and medium-sized enterprises (SMEs) are levied only on profits, and typically after some considerable time lag, as the business will not make a tax return until some time after a profits period or local fiscal deadline has passed. Welcome though the reduced liability will be at that time, if the business has not yet made a profit at all then the question of taxes is unlikely even to arise, making other incentives and aids to business success more important in the earliest days of the venture.

#### **How easy is it to withdraw money from the business?**

A sole trader is typically free to use the funds of the business as he or she sees fit. There are no restrictions on how much of the firm's profits can be taken, or how often withdrawals may be made. The proprietor will be restricted only by the practical need to ensure that the business retains enough money to keep operating. In the case of a partnership, the rules

governing withdrawal of profits and funds will be dealt with by each individual firm's in-house partnership agreement.

Where the business is a separate legal entity, and its assets belong to it and not to its individual members, there are likely to be, at the very least, legal restrictions on how funds may be distributed back to investors. In practice these may well be a mere formality, especially in the case of a single shareholder-director company (where these are allowed under local legislation) but otherwise companies are restricted in the ways in which they may distribute funds to their directors and shareholders.

As noted above, many cooperatives and charitable structures impose significant restrictions on the distribution of cash from the enterprise. It is common for the statutory provisions setting up farming cooperatives and the like to have conditions that not only restrict the venture's scope for making cash returns to members, but also require it build up cash reserves out of each year's operating surplus in order to fund future capital investment by the cooperative, for example in improved machinery or storage facilities.<sup>1</sup>

Similarly, the constitution of a charitable enterprise, in addition to restrictions on distributing returns during the life of the enterprise, will often include a stipulation that any funds held by the body on a winding-up may only be distributed to another charitable body pursuing similar aims to its own.<sup>2</sup>

When considering the integration of such restrictions into domestic business form design, policymakers will need to balance the strictness of the rule with the burden of operating it. An exclusively charitable organisation will have no need to return capital to its investors, and will be suitably served by a simple rule requiring any profits to be retained in the business and spent in pursuance of the charity's ends. A farming cooperative, on the other hand, existing for the benefit of its own membership, might be better served with a more complex rule that allows for distributions above a certain level of profit, after a suitable amount has been reinvested into the business to ensure its sustainability.

<sup>1</sup> For example, Indian Cooperatives and Nidhi and Producer Companies. For general information see <<http://www.indiancooperative.com/>>, accessed 25 February 2019.

<sup>2</sup> For example, the Singapore Public Company Limited by Guarantee, Indian cooperatives, Irish Guarantee Companies and the UK CIO/SCIO models.

# Investing into the business



**One of the most fundamental considerations is whether or not the owners will need access to money beyond their own resources to develop the business.**

Policymakers will need to consider which funding mechanisms to encourage, and whether government funds should be made directly available to certain forms of business, and if so on what basis.

The simplest way of introducing money to a business is often to borrow it, which will involve paying interest. Typically, the cost will be based on how much is borrowed, regardless of the predicted proportional return on that sum.

For a corporate body, however, there is also often scope for raising money as equity, so that the investor receives a return only if the business actually returns a profit on the investment. Furthermore, whether a company raises money as debt or equity, lenders/investors are typically more ready to put funds into a company than into a sole trader or partnership – either lending more, or at lower rates of return (OECD 2015).

Corporations are perceived as having a degree of stability and permanence which unincorporated businesses do not – although for many small businesses the owners will have to give a personal guarantee anyway, diluting any potential benefits of the separate legal personality (OECD 2015; ACCA 2013).

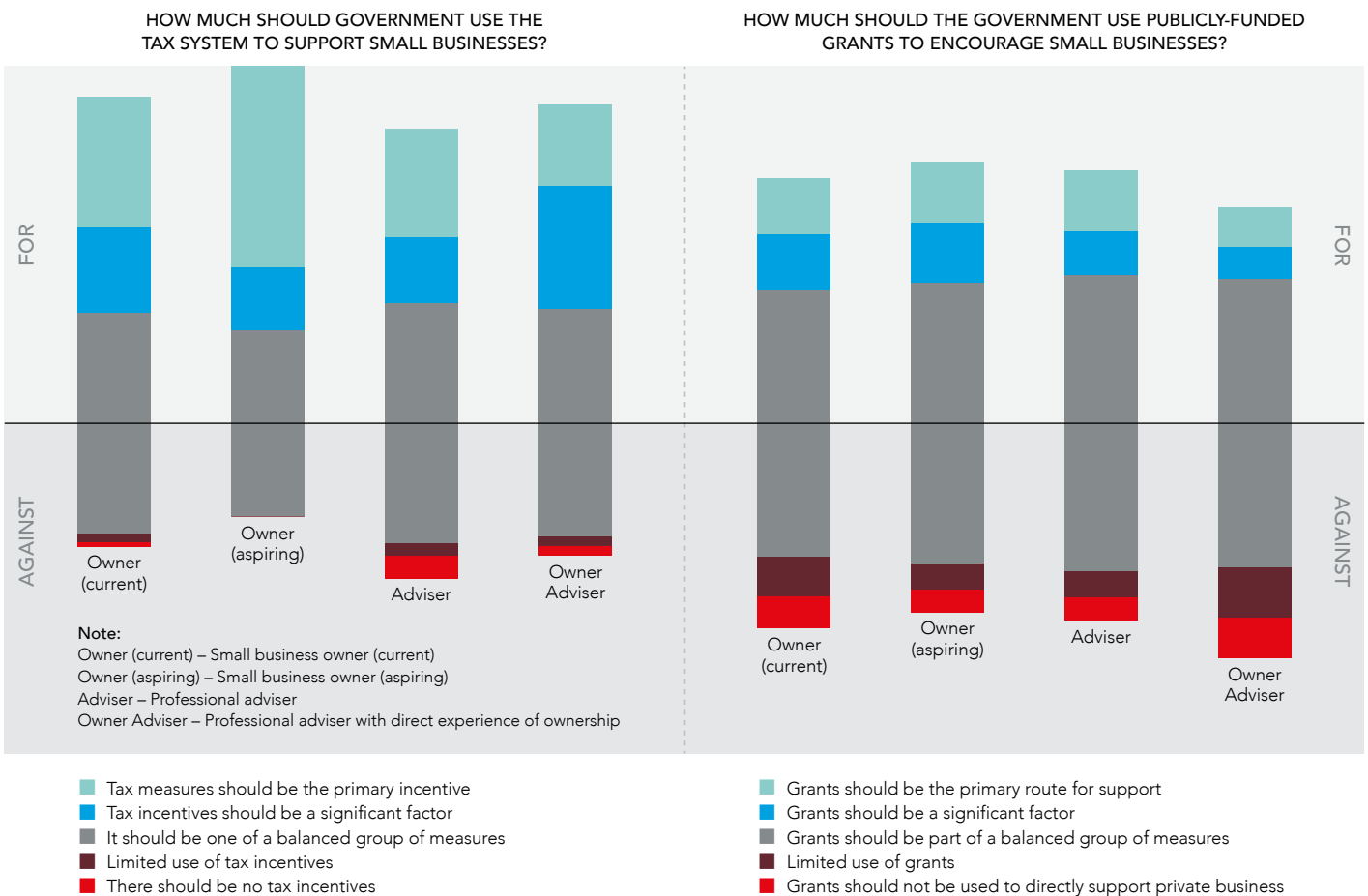
There may be other sources of funding, such as government grants, which are often targeted at smaller firms, and again, as with realising returns, it is important to understand the tax impacts of different funding models. For all groups of ACCA's survey respondents, the attractiveness of grants was lower than that of tax incentives, with a clear majority (62%) seeing them as part of a balanced package of measures to assist small business. Nevertheless, it will be important for advisers to be aware of the grants available, and of the sources of information that should be consulted to stay up to date on sector-specific and local incentives.

For all groups of ACCA's survey respondents, the attractiveness of grants was lower than that of tax incentives, with a clear majority (62%) seeing them as part of a balanced package of measures to assist small business.

One aspect of investing to develop the business that can be hard to assess is the time and effort needed to establish networks of customers and suppliers. The difficulties faced were captured by a comment from one survey respondent: 'Two of the biggest problems for any new SME are: 1) where to find clients; 2) where to find capital. Hence, if government wants to engage in meaningful support activities, I would see them concentrate efforts on promoting TRULY WORKING [capitals original] business exchanges, trade associations' membership support, making government contracts more accessible, etc. and supporting funding efforts through some sort of [government] guarantees for qualifying business projects that would allow the owners to draw credit from commercial banks.'

While access to business exchanges and support networks is rarely dependent on the legal form of the enterprise, it can nevertheless be an absolutely crucial factor in the success of a new business (ACCA 2019). Policymakers should consider the active creation and support of local initiatives and groupings that can help entrepreneurs achieve their business aims. Such networks can increasingly be found online, and the power of social media and an internet presence should not be underestimated. The investment of time required to curate an online brand will initially need to come from within the business. In certain sectors and particular markets this will be more important to long-term success than cash investment and should be given the appropriate level of prominence in the business plan (OECD 2018).

FIGURE 4: Grants vs Taxes



# Legal characteristics



**The defining legal characteristic of a business form will be whether the business has a separate legal identity from its owner(s). Deciding whether the enterprise will need its own identity, and the capacity to own things in its own right, or can simply exist as an extension of the legal name(s) of the owner(s), goes to the heart of its relationships with the outside world, and determines where liability will fall for any issues that arise.**

Companies and other 'bodies corporate' exist as independent legal entities, able to enter into contracts and enforce (or be subject to) rights and liabilities. That contrasts with the sole trader's position, where everything is done directly in the name of the individual responsible. In addition, use of a separate legal personality can greatly simplify selling, or transferring, part or all of the business. At the same time, it will impose restrictions on the legal power of the owners and/or managers to deal with the assets of the business, or enter into contracts on its behalf.

Respondents across the whole survey population viewed separate legal personality as an important factor when choosing a business form, with 75% rating it as an important or very important consideration. Closely linked to the issue of separate legal personality is the matter of liability for the debts of the business. Respondents considered this an even more significant factor, with fully 80% classing it as important or very important.

Nonetheless, while it is understandable that the direct risk to the founders' personal financial security ranks highly as a consideration, what complicates the situation is that, where a business enjoys limited liability status, the individuals behind that business are generally able to take shelter from the consequences in the event of their own poor or reckless decisions and initiatives, while those third parties who deal with them, including trade creditors, employees and government departments, are left to count the cost. Invariably, jurisdictions will impose conditions on the conduct of business by limited liability companies so as to deter abuse of the system and to compensate third parties for the risk they run in doing business with companies (ACCA 2013).

Policymakers will need to consider carefully the balance between encouraging innovation and risking abuse of the limited liability protections. Limited liability has been characterised as

**First, from the moment of incorporation, the company is treated as an entity separate from both the individuals who own the company as its shareholders and those who manage it as its directors.**

socialising risk, by sharing the potential costs of the failed investment across the whole of society.

It is worth bearing in mind that courts might sometimes look behind the company identity (sometimes known as piercing the 'corporate veil') to hold owners or directors personally liable, usually where there has been criminal activity. On the other hand, in many jurisdictions there are personal bankruptcy safeguards that protect the entrepreneur from total ruin in the event that unexpected liabilities arise (ACCA 2013). Again, a balance is needed between offering protection to any individual in bankruptcy or offering protection only to those who operate a business through a particular (limited liability) format.

In addition to the above, the law will typically lay down a large number of criminal offences for breach of statutory responsibilities, which can be viewed as highly persuasive incentives for companies to respect the interests of their shareholders, in particular, and in some cases their creditors as well. For example, directors may commit criminal offences if they approve annual accounts that do not comply with legal requirements, make solvency statements that are not supportable, fail to keep minutes of their meetings, or fail to provide information to a company auditor on request. In some circumstances, a company's shareholders may be able to bring legal proceedings, in the name of the company, against its directors (Gerner-Beuerle et al. 2013; Cheffins and Black 2006).

Any regulatory regime for limited companies is likely to include a system of interrelated checks and balances. Where rules on accounting and disclosures exist, they will form part of such a system, and where they do not, compensating measures are likely to be present (ACCA 2013). The optimum regime for a given enterprise cannot therefore be considered in isolation from consideration of how the regulatory framework overall provides appropriate safeguards for investors, creditors and the public interest. While small companies in Australia, for example, are not bound to prepare or publish annual accounts, the

financial interests of their stakeholders are addressed by requirements that directors make an annual declaration of solvency and that decisions on distributions take stakeholders' interests expressly into account.

In countries that have more extensive and standardised requirements governing accounting and public disclosure, such as the UK, those measures may be seen as a substitute for the more stringent rules on personal liability that exist in other company law regimes. The particular contribution that accounting and disclosure can make to the goal of protecting stakeholder interests and the public interest in any individual company law regime will accordingly be a function of the wider regulatory framework within which companies exist.

Determining where the optimal balance lies in any given jurisdiction will invariably involve an assessment not only of the costs and benefits of meeting standardised accounting and disclosure practices, but also of how those obligations coexist and interact with other measures that provide necessary protections for stakeholder interests. Policymakers should also consider the costs of operating the regulatory bodies and registers needed to give effect to the obligations imposed on business in return for limited liability.

### **The practical consequences of separate legal personality**

The assumption of a business form with its own separate legal personality has three important practical consequences for its owner.

First, from the moment of incorporation, the company is treated as an entity separate from both the individuals who own the company as its shareholders and those who manage it as its directors. Although the position varies between and within jurisdictions, any legal action by an aggrieved customer or client of the company, or a third party, will typically need to be taken against the company rather than against its shareholders or directors, unless there is a clear breach of specific personal duties by an individual, such as knowingly criminal behaviour by a director (Gerner-Beuerle et al. 2013).

**The shareholders in a limited company enjoy limited personal liability for the debts of their company. Shareholders, as such, have no personal responsibility for the debts incurred by their company in the normal course of trading.**

The second main consequence of incorporation is that the company's existence continues independently of the identity of its shareholders and directors. Shareholders are usually free to sell their shares if they wish to do so. Even when there is a complete change of ownership, for example where the company is taken over by another business or where a sole shareholder dies and his interest is passed on, the company survives and continues in existence. Therefore, the company format allows a business to be planned for the long term.

The third main consequence of incorporation is that the law invariably treats shareholders and directors differently. If one individual is involved as both a shareholder and a director then there will be different rules (and potentially liabilities) to be considered, depending on whether the individual is acting as a director or as a shareholder.

The shareholders in a limited company enjoy limited personal liability for the debts of their company. Shareholders, as such, have no personal responsibility for the debts incurred by their company in the normal course of trading. In the case of a company limited by shares, the liability of each member is limited to the amount of share capital subscribed. Where, as will often be the case, the full value of the shares has been paid into the company, then there is no further liability to meet. If a company goes into liquidation because it cannot pay its debts, its shareholders will be required, at most, to pay to the liquidator any amounts remaining unpaid on their shares – where shares are 'fully paid', that amount will be nil.

Against this, shareholders bear the ultimate risk in a company, in the sense that, if their company fails, they stand to lose whatever amounts they have invested in their company. In any winding up, shareholders will see a return only if there are still assets available after all the creditors have been paid. Accordingly, if a company is wound up on an insolvent basis, shareholders can expect to lose the entire value of their investment.

A company's directors, on the other hand, are entrusted with controlling the affairs of their company. The law will require them to do this in a disciplined way that takes account of the need to protect the interests not only of the company's shareholders but also of some third parties. In the case of small companies, the shareholders and directors are usually the same people. There is nothing untoward in this but individuals in this situation need to remember the technical distinction that exists between the ownership rights that they have as shareholders and the management responsibilities they have as directors.

This distinction is very often demonstrated, in the case of small companies in particular, by the fact that banks and other lenders of finance will usually insist, as a condition of agreeing to lend funds to a small company, that its director or directors give personal guarantees that the loan will be repaid (ACCA 2013). Thus, while as shareholders they have limited personal liability for their company's debts, as directors they may take on personal responsibilities for those same debts.

# Administrative requirements



These are often driven by the legal characteristics of the business and tend to fall into two categories – occasional requirements, such as the formalities governing the initial start-up or major transactions such as a sale of the business, and regular requirements such as preparing and filing or publishing accounting information, or observing certain formalities for transactions, for example dealings between the investors and other stakeholders, such as managers or employees.

There is often a trade-off between the level of administrative requirements and the degree of autonomy that the business can have, linked with the related fields of transparency and accountability.

Starting the business is something that happens only once. The legal form adopted by the business should be based on long-term factors, not just the ease of the start-up process. It is important, nonetheless, to understand what needs to be done, how long it will take and what it might cost. This is particularly the case in those jurisdictions where the formalities of the incorporation process are more burdensome. Policymakers should, as a rule, try to minimise those burdens, retaining formality only where there is a good policy reason for doing so.

Although there is a widespread shift to adopting modern technological methods, with central registers maintained in digital format and registration processes accordingly moving online, the change is

by no means universal. Around the world, the time taken to incorporate a business has fallen on average from 47 days in 2006 to 20 days in 2018, but this masks a wide variation, from 2.5 days in Australia to 40 in South Africa and 70 in Somalia (World Bank 2019: 202).

While the convenience of online filing and information sharing offers real productivity gains for both the administrators and users of business information and records, the ease of online incorporation and business transactions has also been linked to a shift in patterns of criminal behaviour (ICLEG 2016). National registries are faced with a trade-off between ease of business registration and the need to combat criminal and fraudulent behaviour. Although the digital exchange of business information between authorities, regulators and crime fighting agencies can aid them in the fight to protect the public, the usefulness of the exchange will depend on the reliability of the information contained in

**61%**  
of respondents rated crowdfunding a high-risk area, justifying additional regulation such as third-party oversight

their registers, so it is increasingly important that steps are taken to ensure confidence in the accuracy and completeness of that information.

The initial registration of the business is often the moment that offers the best opportunity for the authorities to assess the good standing and good faith of those behind it. The greater the powers of the business to contract with third parties and create liabilities on its own behalf, the more important it is that the authorities are able to maintain confidence in the business form that justifies those powers.

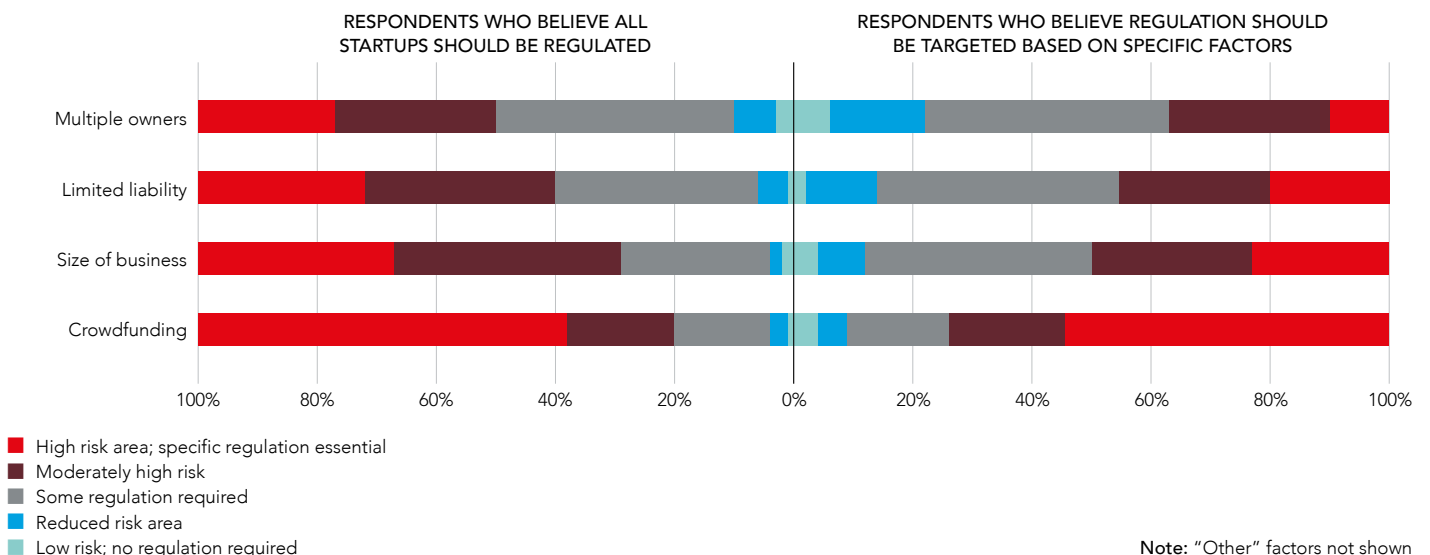
Just under 70% of all survey respondents considered that all new businesses should be subject to compulsory registration or regulation, with only a slight variance between groups. Professional advisers who do not run their own business were the most likely to advocate compulsory formalities, at 73%, while those who were considering a new venture were least likely to support such a measure. Nonetheless, nearly two-thirds (64%) of the latter agreed that all new businesses should be subject to some degree of official monitoring.

There was, however, considerable variation between the populations over the factors that they argued should trigger regulation. Some 40% of aspiring business owners, nearly twice the proportion of non-business-owning advisers, stated that the limitation of owners' liability was a high-risk

area requiring additional regulation. Similarly, while most respondents considered that the size of the business was a factor which should be taken into account, with additional regulation desirable above a certain (unspecified) size, the degree of importance was again subject to differing opinions. Advisers who had set up their own business were only half as likely to consider it a high-risk area (21%) as those advisers who had not set up a business themselves (42%), although 50% of owner-advisers did consider some additional regulation desirable (against 30% of 'non-owner-advisers'). Whichever option policymakers choose to pursue, they should be prepared to justify the scope and design of regulation for new businesses by reference to the risks identified and the proportionate nature of the safeguards.

Turning to the newer challenges facing policymakers, when asked about crowdfunding, 61% of respondents rated this a high-risk area, justifying additional regulation such as third-party oversight. Just one respondent considered direct calls on public funds to be a low risk factor requiring no regulation at all. Those looking to set up a business were the most concerned about this area, with 83% seeing it as an activity justifying additional regulation, indicating a widespread recognition of the possible risks, and an acceptance of the corresponding administrative burdens to be expected.

**FIGURE 5:** Crowdfunding is seen as the highest risk area both by respondents who believe all startups should be regulated (left hand side) and those who believe regulation should be targeted based on specific factors (right hand side)



Note: "Other" factors not shown



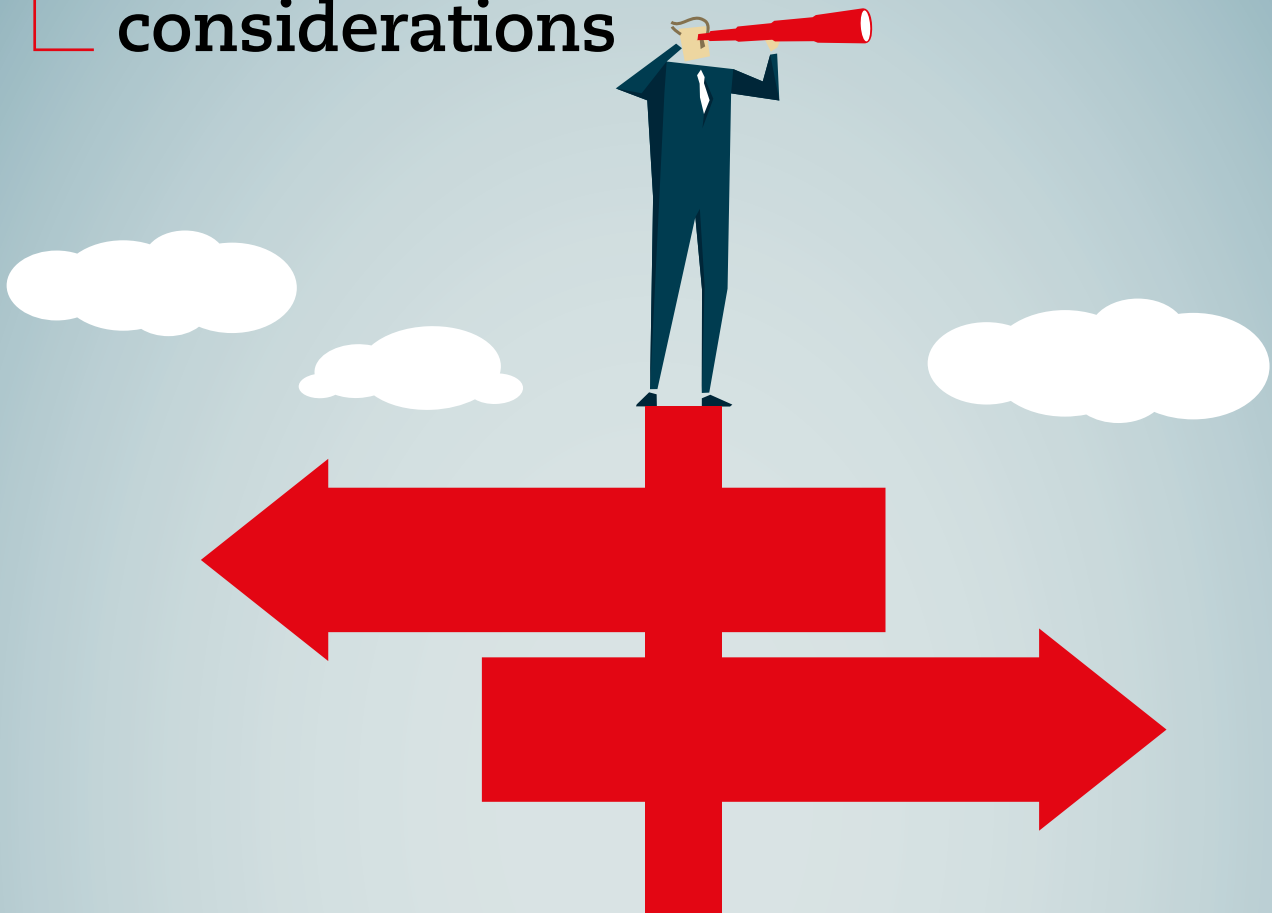
**Overall, though, there is a general pattern across jurisdictions that the formalities with which directors have to comply to keep shareholders informed have fallen since the year 2000.**

The majority of aspiring business owners recognise the need for some regulation and appear comfortable with the concept that limited liability will come with additional administrative responsibilities, so policymakers can approach the topic accordingly.

Overall, though, there is a general pattern across jurisdictions that the formalities with which directors have to comply to keep shareholders informed have fallen since the year 2000. At the same time, the ease with which those obligations that survive can be discharged has in many cases been enhanced through the availability of digital communications. For instance, many jurisdictions now allow electronic communications and share transfers, and even the holding of general meetings online or through video-conferencing (ICLEG 2016; Collis et al. 2018).

Such changes often reflect the very widespread reality that, in small private companies, directors and shareholders are often one and the same. For example, since the Companies Act 2006 came into force, private companies in the UK no longer have to hold an annual general meeting (AGM) or to present their accounts for review by shareholders at a general meeting. They can also pass company resolutions in writing, rather than going to the trouble of holding a general meeting to do so. Given pressures on regulator funding and resources since the global financial crisis of 2008–9 and resultant incentives for focusing compliance resources on identified risks rather than blanket monitoring, it seems likely that this trend in favour of the lighter routine administrative regulation of private companies in the UK will continue, although some trade-off in the form of enhanced monitoring of high-risk events, such as large individual transactions and initial registrations, might reasonably be expected.

# Some broader considerations



## TRANSPARENCY AND ACCOUNTABILITY

There is often a trade-off between the level of rights or freedoms a business vehicle has and the amount of information about itself that it has to make public (ACCA 2013). The link is sensible – for example, where companies can raise money from the general public through ‘listed’ securities they have to publish considerable amounts of legal and financial information so that investors can make an informed decision and, as noted above, this is a risk recognised by all those surveyed.

Likewise, entities that enjoy limited liability are usually required to report or publish financial information so that potential creditors can understand what limits there might be to recovery if they do enter into a financial relationship with the business. The disadvantage is that there can be concerns about divulging commercially sensitive information, or even personal details about owners or managers.

The rationale for imposing accounting and disclosure requirements on companies has always been that it is in the public interest for companies to be subject to standardised regulation in these matters to balance the special legal privileges that flow from the award of limited personal liability to company owners.

**Studies have found that avoidance of public disclosure of potentially sensitive business information is one of the principal reasons why SMEs choose where possible to file abbreviated accounts.**



The rationale can be explained in these terms:

- a company should be required to manage its financial affairs in specified ways that respect and reinforce its separate legal personality
- given the separation, under company law, of ownership and management, rules are needed to protect the interests of the former and to clarify the responsibilities of the latter
- since the persons who own and control a company will not be personally responsible for their company's debts, rules are necessary to reduce the risk that third parties assume when doing business with them.

Studies have found that avoidance of public disclosure of potentially sensitive business information is one of the principal reasons why SMEs choose where possible to file abbreviated accounts (Collis 2012; Allee and Yohn 2007). Many companies that file abbreviated accounts are likely to do so in order to avoid disclosing information that might be used to their disadvantage: for example, they may fear that suppliers might raise prices, employees might seek higher salaries and customers might seek discounts if they believed that the company was successful.

The consequence of filing modified information, however, is that there is a reduction of transparency on the public record. Where only abbreviated information is made available, prospective lenders may act more cautiously, and be encouraged to require additional information before making a decision on a loan, credit rating or insurance policy (ACCA 2013: 28). This is an indirect argument for making available the full financial statements rather than a modified version.

Another argument that is frequently presented to justify mandatory accounting rules (and associated legal requirements for keeping adequate accounting records) is that they encourage financial discipline, which in

turn acts as an indirect safeguard for companies' shareholders and creditors. Deadlines imposed for filing a set of accounts or making a public solvency declaration are seen as another strong incentive for ensuring correct financial management in that they act as a spur to companies to prepare their accounts in good time: failure to file annual accounts or prepare solvency statements on time is often seen as a warning sign of internal problems, in particular that the company has not been able to agree its accounts (ACCA 2013).

Were companies to be freed from any obligation to report on their financial affairs on a regular basis, there could be a risk that those companies would find it more difficult to win and retain business and to access finance, because the risks associated with doing business with them would increase. It may also be that poor behaviour on the part of some small companies would translate into a reduction in confidence in smaller companies more generally, to the detriment of the wider business community and, in the long run, society as a whole.

The rights that a business has, for example to protect its name or enter into contracts, are usually reflected in the responsibilities it has for filing accounts or maintaining reserves for its creditors. Such responsibilities will be reflected in running costs and earning opportunities, as well as the obligations the business has for paying taxes.

The mechanisms that society has for holding a business to account for its actions, whether in respect of investors, creditors, employees or customers, may vary depending on the business form. The culpability of the decision maker may influence whether remedies are based on civil law or criminal sanctions, while holders of formal defined offices, such as director, may benefit from legal protections or even indemnity (Gerner-Beuerle et al. 2013; Zurich 2017).

**Under-resourcing the safeguards that protect the integrity of business systems is a false economy that would devalue all the effort and expense put into creating the regulatory framework in the first place.**



### **ABUSE OF FORMS – CONTROLS AND SAFEGUARDS?**

The flipside to having choice of forms and the alternatives they offer is that the flexibility may be misused or even deliberately abused. Innovations such as bearer shares, limitation of liability and ownership of business assets through trusts all have valid uses but can also be subject to abuse.

Over time, aspects of the business form regime that previously played a useful role can be superseded by technological advances. The benefit they provide can be achieved through other means without the weaknesses that enable abuse. For example, bearer shares originally played a useful role in promoting liquidity in a paper-based records system. Advances in digital communication have overtaken that benefit while concerns about transparency of ownership, and offences such as money laundering and terrorist financing, have led to a perception that bearer shares no longer serve a sufficiently useful purpose in financial markets to outweigh the risks of abuse (FATF 2012: Recommendation 24). As a consequence, many jurisdictions no longer allow the issue of bearer shares, and have implemented measures for converting existing issues into conventional, registered, ordinary share capital (see, eg for the UK, H.M. Government 2014; for Switzerland, STEP 2018).

The ownership of business assets through trusts is often used in employee ownership models, widely held to be a sustainable model with a number of specific advantages (Nuttall 2012) including the well-being of employees (McQuaid et al. 2012). Nonetheless, the trust mechanism is also widely used to disguise beneficial ownership, and in this way can be used to avoid or evade taxes or hide the source of money (FATF and Egmont Group 2018). The implementation of effective and proportionate safeguards against the risk of deliberate abuse needs to be a feature of the regulatory framework, and should be designed with the same care and attention to detail as the underlying enabling structures.

The costs of maintaining controls and safeguards should not be underestimated. Measuring the costs and benefits of regulatory frameworks is challenging (Revesz 2016) but just as businesses are accountable to their stakeholders, so policymakers should hold themselves accountable to the public for whom they act. Under-resourcing the safeguards that protect the integrity of business systems is a false economy that would devalue all the effort and expense put into creating the regulatory framework in the first place.

# Sources and methodology



**This report builds on ACCA’s existing body of guidance for members. In addition to drawing on these previous publications, ACCA undertook a desktop survey of available business forms in nine jurisdictions (UK, Ireland, India, Pakistan, China, Singapore, Malaysia, Nigeria and Hong Kong), analysing the key features under four main themes: realising the returns; investing into the business; legal characteristics; and administrative requirements.**

Following this, ACCA surveyed targeted professional advisers in practice (50%), existing small business owners (48%) and, finally, those actively considering the founding of a small business (23%) and garnered 345 respondents from 60 jurisdictions, 49% of individual responses from Western Europe, 19% Africa, 13% Asia-Pacific, 6% Caribbean and the balance from other regions.

Questions were designed to identify those features of the business model that were considered to be most important by each group, with a view to helping advisers recognise which aspects of the business format are likely to be most important or attractive to clients and prospective clients.

## **The survey results identified four main populations:**

- entrepreneurs with practical experience of small business operation but no related professional advisory experience (**32%**)
- professional advisers who had practical experience of small business operation (**16%**)
- professional advisers with no practical experience of small business operation (**30%**), and
- entrepreneurs with no previous experience who were actively considering setting up a business (**19%**).

A comparison of responses between the populations indicates areas that are universally seen as important, and those where an adviser’s focus might differ from that of their clients.

# References

- ACCA (2013), *Protecting Stakeholder Interests in SME Companies*, <<https://www.accaglobal.com/content/dam/acca/global/PDF-technical/small-business/tech-tp-psiis.pdf>>, accessed 12 June 2019.
- ACCA (2019), *ACCA (2019), Scale-up Success: What do SMEs Need to Supercharge their Growth?* <[https://www.accaglobal.com/content/dam/ACCA\\_Global/professional-insights/Scale-up/pi-scale-up-success-SMEs.pdf](https://www.accaglobal.com/content/dam/ACCA_Global/professional-insights/Scale-up/pi-scale-up-success-SMEs.pdf)>, accessed 12 June 2019.
- Allee K. and Yohn T (2007), *The Demand for Financial Statements in an Unregulated Environment: An Examination of the Production and Use of Financial Statements by Privately-Held Small Businesses*. SSRN/Elsevier (December 2007). Downloadable from: <<https://ssrn.com/abstract=647721>>, accessed 12 June 2019.
- Cheffins, B. R. and Black, B. S. (2006), 'Outside Director Liability Across Countries' (1 July) *Texas Law Review*, 84: 1385–480, 2006; *ECGI – Law Working Paper No. 71/2006*; *Stanford Law and Economics Olin Working Paper No. 266*; *University of Texas Law and Economics Research Paper No. 31*. Downloadable from: <<https://ssrn.com/abstract=438321>> or <<http://dx.doi.org/10.2139/ssrn.438321>>, accessed 25 February 2019.
- Collis, J. (2012), *Determinants of Voluntary Audit and Voluntary Full Accounts in Micro- and Non-micro Small Companies in the UK* (Hillingdon: Brunel University).
- Collis, J., Alkhatib, E. and de Cesare, S. (2018), *Costs and Benefits to Small Companies of Digital Reporting*. Downloadable from <<https://bura.brunel.ac.uk/handle/2438/15686>>, accessed 12 June 2019.
- FATF (Financial Action Task Force) (2012), *International Standards on the Combating of Money Laundering, Terrorist Financing and Proliferation: The FATF Recommendations*. Downloadable from: <<http://www.fatf-gafi.org/publications/fatfrecommendations/documents/fatf-recommendations.html>>, accessed 12 June 2019.
- FATF and Egmont Group (2018), *Concealment of Beneficial Ownership*, <<https://www.fatf-gafi.org/publications/methodsandtrends/documents/concealment-beneficial-ownership.html>>, accessed 12 June 2019.
- Gerner-Beuerle, C., Paech, P. and Schuster, E.P. (2013), *Study on Directors' Duties and Liability*. Prepared for the European Commission, DG Markt. <[http://eprints.lse.ac.uk/50438/1/\\_Libfile\\_repository\\_Content\\_Gerner-Beuerle,%20Study%20on%20directors%E2%80%99%20duties%20and%20liability\(lsero\).pdf](http://eprints.lse.ac.uk/50438/1/_Libfile_repository_Content_Gerner-Beuerle,%20Study%20on%20directors%E2%80%99%20duties%20and%20liability(lsero).pdf)>, accessed 4 June 2019.
- H.M. Government (2014), 'The Small Business, Enterprise and Employment Act is Here', <<https://www.gov.uk/government/news/the-small-business-enterprise-and-employment-bill-is-coming>>, accessed 12 June 2019.
- ICLEG (Informal Company Law Expert Group) (2016), *Report on Digitalisation in Company Law*, <[https://ec.europa.eu/info/sites/info/files/icleg-report-on-digitalisation-24-march-2016\\_en.pdf](https://ec.europa.eu/info/sites/info/files/icleg-report-on-digitalisation-24-march-2016_en.pdf)>, accessed 25 February 2019.
- McQuaid, R., Hollywood, E., Bond, S., Canduela, J., Richard, A. and Blackledge, G. (2012) *Fit for Work? Health And Wellbeing of Employees in Employee Owned Business*, <<https://employeeownership.co.uk/wp-content/uploads/Fit-for-Work.pdf>>, accessed 11 June 2019.
- Nuttall, G. (2012), *Sharing Success The Nuttall Review of Employee Ownership*, <[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/31706/12-933-sharing-success-nuttall-review-employee-ownership.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31706/12-933-sharing-success-nuttall-review-employee-ownership.pdf)>, accessed 12 June 2019.
- OECD (2015), *New Approaches to SME and Entrepreneurship Financing – Broadening the Range of Instruments*, <<https://www.oecd.org/cfe/smes/New-Approaches-SME-full-report.pdf>>, accessed 12 June 2019.
- OECD (2018), *Enabling SMEs to Scale-up – Plenary Session 1*, Discussion Paper – SME Ministerial Conference 22–23 February 2018, Mexico City <<https://www.oecd.org/cfe/smes/ministerial/documents/2018-SME-Ministerial-Conference-Plenary-Session-1.pdf>>, accessed 22 February 2019.
- Revesz, R. (2016), 'Cost-Benefit Analysis and the Structure of the Administrative State: The Case of Financial Services Regulation' *New York University Economics and Law Working Papers* (NELLCO Legal Scholarship Repository), <[https://sr.nellco.org/cgi/viewcontent.cgi?article=1432&context=nyu\\_lewp](https://sr.nellco.org/cgi/viewcontent.cgi?article=1432&context=nyu_lewp)>, accessed 11 June 2019.
- Sabir, H.M., Tahir, S., Arshad, S. and Bin Nasir, S. (2012), *Future of Cooperative Farming in Pakistan*, <[https://www.researchgate.net/publication/277830050\\_Future\\_of\\_Cooperative\\_Farming\\_in\\_Pakistan](https://www.researchgate.net/publication/277830050_Future_of_Cooperative_Farming_in_Pakistan)>, accessed 25 February 2019.
- STEP (Society of Trusts and Estates Practitioners) (2018), 'Switzerland Bows to OECD on Bearer Shares' [website article] <<https://www.step.org/news/switzerland-bows-oecd-bearer-shares>>, accessed 12 June 2019.
- Trebbin, A. and Hassler, M. (2012), 'Farmers' Producer Companies in India: A New Concept for Collective Action?', *Environment and Planning A*, 44 (2): 411–27 <<https://journals.sagepub.com/doi/pdf/10.1068/a44143>>, accessed 25 February 2019.
- World Bank (2019), *Doing Business 2019, Training for Reform*, 16th Edition of World Bank Doing Business Index, <[http://www.worldbank.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report\\_web-version.pdf](http://www.worldbank.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2019-report_web-version.pdf)>, accessed 26 November 2018.
- Zurich (Zurich American Insurance Group) (2017), *D&O Corporate Indemnification: A Reference Guide by Country*, <[https://www.zurichna.com/\\_/media/dbe/zna/docs/kh/mgmt/dando-corporate-indemnification-a-reference-guide-by-country.pdf?la=en](https://www.zurichna.com/_/media/dbe/zna/docs/kh/mgmt/dando-corporate-indemnification-a-reference-guide-by-country.pdf?la=en)> accessed 25 February 2019.



