13

Businesses and the business environment

Learning objectives

After studying this chapter you should be able to:

- Appreciate the importance of commercial awareness.
- Explain the main types of legal business structure, their organisation, and management.
- Explain different markets, sectors, and industries in which businesses operate, and the role of consumers within these markets.
- Understand a simple supply chain.
- Recognise the impact of competition within different markets.

Introduction

So far in this book, you have looked at what the law is, the legal systems that govern it, where to find it, and the legal skills that you need to use once you have found it. You have also thought about employability skills: the personal and professional skills that you need to get your training contract, and to succeed once you get into practice. It should be clear to you now that if you think that your career will *just* be about giving legal advice, then that career will be short lived. Lawyers, like everyone else involved in business of any sort, need to show commercial awareness. We explore what commercial awareness is and why you need it. We then look at law firms and their clients and the relevance of these issues for lawyers, but, in fact, commercial awareness is something that all students need, whether they they hope to be involved with the law, or any other profession or industry.

Chapters 14 and 15 introduce you to the fundamentals of commercial awareness. We look at business structures and organisation, basic economics, financial markets and banks, accounts, and insolvency. You may be wondering why any of these are relevant. At the beginning of your career, you cannot be expected to have the same commercial understanding as a partner who has been practising for 20 years. However, commercial awareness is an essential aspect of your professional development, and it is never too soon to start developing this knowledge. Commercial awareness is crucially important when completing your application forms and at interview. Law firms, and indeed all employers, expect you to be able to demonstrate a wide range of skills and competencies. An ability to learn is crucial, and you need to show that you have this ability, both before you get into practice and once you are in practice.

13.1 What is commercial awareness?

The problem with commercial awareness is that there is no neat definition. The term means different things to different people. If you think for a minute about what it means to you, you may come up with something along the lines of 'Commercial awareness is understanding how businesses work.' That is fine as far as it goes, but for lawyers, it means a bit more than this. Lawyers will have clients which are businesses, companies, partnerships, or sole traders; however, they will also have clients who are individuals and who come to them for advice on matters unrelated to business, for example buying a house or getting a divorce. Businesses are run by individuals, the directors of the company, or the partners in a firm. Businesses also have employees, customers, or clients. These are the people with whom lawyers will deal on a day-to-day basis.

You will be faced with typical concerns of those clients, both individuals and businesses: personal, financial, and legal. Understanding those concerns is the first step towards commercial awareness. Then there is one more step. Whether the clients are businesses or individuals, they will be affected by the same external factors. All matters will be affected by what is going on in the world: in other words, by the wider context within which the client operates, whether it be economic, political, social, or financial. So commercial awareness is about understanding businesses and the business and wider environment, which this chapter aims to help you to do, but is also about all of these other factors: your clients' personal concerns, the financial implications, and the wider environment in which they are operating.

You have seen in Chapter 9 that problem solving requires a lawyer to work through several stages before advising the client. The first thing that you will do is establish the facts (why they have come to you?) and then establish the main issues and the client's concerns (what are the client's objectives?). Usually, the client will tell you what she thinks are the relevant facts, what her concerns are, and what she is hoping to achieve. (These are her expectations.) The problem is that this will never be quite the whole story.

Once a client has outlined the matter about which she is consulting a lawyer, and explained her objectives, the next considerations will generally be financial: how much will the matter cost, what will be the financial consequences, and how can the client raise the finance needed to proceed. Once you start to dig a bit deeper, you will find out there are other relevant facts or concerns that the client has not told you about, which may change her objectives. Clients have 'latent' (or hidden) concerns and objectives, often based on facts that they have not even thought about. If you are commercially aware, you should be able to spot them.

The flowchart in Figure 13.1 shows the underlying considerations which lawyers should take into account when advising a client, and how they fit into the problem solving model that you were introduced to in Chapter 9.

Consider this straightforward example (Example 1).

Example 1

You are instructed by a client who tells you that he manages a shop in your local high street. A customer owes £2,500 for goods purchased on credit. The client wants to sue the customer for the amount owed.

The objective appears straightforward. He wants to you to issue proceedings to reclaim the £2,500. You advise the client accordingly.

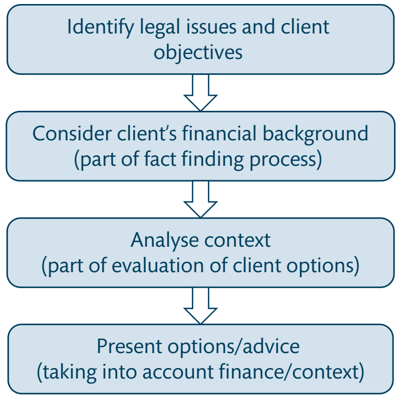

Figure 13.1 Commercial awareness steps

However, if you dig a bit deeper, you can see that this is not necessarily the advice which you should have given.

Example 1 (continued)

You are instructed by a client who tells you that he manages a shop in your local high street. **The shop is part of a national chain of retailers, making annual sales of over £1 million a year. An important corporate customer** owes £2,500. **The customer places regular orders, and there have never been any problems over payment before**. The client wants to sue the customer for the amount owed.

The objective is the same, but is that actually what is best for the company? Factors you should advise on include:

1. The amount owed is comparatively small—the company is a national chain. Does it really need to sue?
2. Litigation will be expensive—if the costs are going to amount to, say £1,500, is it going to be worth it?
3. You are told that the customer places regular orders—is it worth ruining this relationship for £2,500, especially if this is an oversight or a temporary blip?
4. In future, the client should conduct regular credit checks on customers.

None of this is legal advice (although point 2 is based on knowledge of a legal process). It is based on understanding the client's financial position, the environment in which he is operating, common sense, and experience. All of this is commercial awareness.

13.1.1 **Case studies**

These two case studies will help you to understand the importance of commercial awareness. The first is a question which students were asked to consider when applying for a holiday placement at a commercial firm: they were asked to summarise the impact of the BP oil spill in 2010 and to analyse the issues arising as a result. The second is a typical question which could have come up in any interview, legal or non-legal, corporate or non-corporate: what do you think should happen to the Olympic stadium? Once we have analysed these two questions, you will see why Chapters 14 and 15 are so important.

Case study 1

On 22 April 2010, one of BP's deep-water oil rigs in the Gulf of Mexico, the Deepwater Horizon, sank after an explosion. Eleven people died in the blast. The pipe which connected the wellhead to the rig became disconnected and began leaking oil, and the wellhead itself was leaking. Several attempts to reattach the pipe and stop the leak failed and 60,000 barrels of oil per day were leaking into the ocean. It was the US's largest ever oil spill, threatening wildlife along the coast, and bringing the fishing and tourist industries to a halt. President Obama suspended deep-water drilling in the Gulf of Mexico for six months. BP has incurred clean-up and other costs amounting to nearly $40 billion and suffered immense reputational damage as a result.[1]

What issues arise here?

This was an environmental and ecological disaster on an unprecedented scale. For BP, the legal issues resulted in huge pay-outs: 11 people died; BP has incurred the largest ever criminal fine in US history ($4.5 billion, or £2 billion);[2] it has settled compensation claims from fishermen and others whose livelihoods have been threatened, and been responsible for the clean-up costs. A quick internet search reveals that as of June 2012 BP had paid out a total of $8.8 billion (£5.6 billion) to individual, business, and government claims.[3] However, the effects are much more wide-reaching than the environmental and legal consequences.

First, BP is one of the world's largest multi-national public companies, with revenues of $375,517 million in 2011.[4] It is the third-largest company operating in the energy sector (after Royal Dutch Shell and Exxon Mobil[5]). Before you even start analysing the problem, consider whether you know the answer to the following questions:

1. What is a public company?
2. What is a multi-national company?
3. What do we mean by the energy sector?

BP's board of management was criticised for its management of the situation, especially in the US. BP's CEO, Tony Hayward, took part in a yacht race off the Isle of Wight while the oil washed up on the US coast,[6] and declared at the height of the crisis that he wanted 'his life back'. Shortly afterwards, he resigned.[7] Do you know:

1. What is the role of the board of directors of a public company?
2. What is a CEO?

[1] 'BP's PR campaign fails to clean up reputation after oil spill', *The Guardian*, 14 April 2011.
[2] 'BP gets record US criminal fine over Deepwater disaster', *BBC News*, 15 November 2012, http://www.bbc.co.uk/news/business-20336898.
[3] Jaimie Grierson, 'BP still paying for Gulf of Mexico oil spill', *The Independent*, 31 July 2012.
[4] http://www.bp.com.
[5] 'Global 500, 2012 annual ranking of world's largest corporations', *CNN Money*, http://www.money.cnn.com.
[6] 'BP chief Tony Hayward criticised for yacht trip', *BBC News*, 20 June 2010, http://www.bbc.co.uk/news/10359528.
[7] 'BP's Tony Hayward resigns after being "demonised and vilified" in the US', *The Telegraph*, 27 July 2010.

BP's share price fell sharply in June 2010, which means that the value of the company plunged. To meet its losses, BP is selling assets worth $38 billion (£24.4 billion) by 2013.[8] At one point *The Guardian* estimated that £45 billion (36%) had been wiped off the value of the company[9] and there were rumours that BP could face insolvency. This raises further questions:

1. What do you know about shares?
2. Do you know why share prices affect the value of a company?
3. What are assets?
4. Would you know where to look for a valuation of a company?
5. What is insolvency?

BP is one of the UK's largest companies, so inevitably millions are invested in its shares by UK shareholders. The fall in BP shares led a drop in the FTSE 100 leading shares.[10] As well as individual investors, institutional investors such as pension funds and unit trusts have significant holdings in BP. As well as the fall in the value of the shares, the company suspended dividend payments to investors. Can you answer the following questions:

1. What is the stock market?
2. What is the FTSE 100?
3. What are pension funds and unit trusts?
4. Why are share prices important economically?
5. What is a dividend?

The disaster significantly reduced oil production, especially in the US. This led to supply shortages of the world's most valuable commodity, oil. The result was a rise in oil prices, as the US was forced to source oil on the world commodities markets to meet demand. Oil is a fundamental raw material. It is not just the fact that petrol is more expensive at the pumps, but oil in one form or another is used throughout the supply chain, increasing manufacturing and food costs. In the UK, the knock-on effect was a rise in inflation threatening the fragile economic recovery. Further questions are:

1. What is a commodity?
2. What are commodity markets?
3. What sort of resource are raw materials?
4. What is the supply chain?
5. Why are supply and demand so important?
6. What is inflation?
7. Why does rising inflation have an effect on the economy?

8 Jaimie Grierson, 'BP still paying for Gulf of Mexico oil spill', *The Independent*, 31 July 2012.
9 Graeme Wearden, 'BP oil spill: shares fall further', *The Guardian*, 2 June 2010.
10 Terry McAlister, 'BP facing multimillion-dollar legal claim from British pension fund', *The Observer*, 30 May 2010.

How did you do? It does not matter if the answer is 'Not very well.' The point here is that one question, which appears on the face of it to be about legal issues, gives rise to a large number of underlying issues covering economics, financial markets, business structures and organisation, accounts, and insolvency, and raises the sort of questions which you may meet in interviews. It does not matter how well you analyse the legal issues; if you do not know some of the basics of the topics that we are going to cover, you will not stand out. Incidentally, the firm that set this question was an LLP (see 15.2.4). If you got an interview with this firm, what would you find out first? At the end of the chapter, there is a question which you can answer on this.

If you are not considering corporate practice, you may be thinking that none of this has any relevance to you. This is not the case. You can easily give yourself away at interviews, by something as simple as calling a partnership a company, or not knowing why a company is a public or private company.

Throughout these chapters, we are going to look at some typical interview questions, which we will refer to as 'Sample interview questions', so that you can see how you might be expected to apply your commercial knowledge, in both corporate and non-corporate contexts. As a general rule, legal interview questions divide into categories: personal questions, legal questions, questions about the legal profession, questions about the firm, and current affairs questions of the type: 'Give your opinion on ...'. Case study 2 is an example of the latter. Case study 2 is the Olympic stadium example that was also mentioned in Chapter 10. Students were asked: 'What do you think should happen to the Olympic stadium now that the Games are over?' This is the sort of question you could be asked at any interview.

Case study 2

The Olympic stadium was built with public money at an estimated cost of £423 million. It had a capacity of 80,000 people for the Olympics, but was built in such a way that this can be reduced to 25,000. With the Olympics over, what do you think should be done with it? What are the issues here?

You have probably given no more than a passing thought to the Olympic stadium since the Games were over, and may have no opinion at all about what should be done with it. However, you need to provide an answer that shows that you are commercially aware.

If you can, you could start by showing you know what is going on, and putting the future of the stadium in context. You may know that the Olympic Park is going to be developed to provide housing in Stratford: over 6,000 new homes (a third will be affordable housing), with schools, nurseries, and playgrounds eventually will be built. If you do, it shows that you follow the news and are aware of topical issues. The need for housing, and especially affordable housing, is a topical social issue. In November 2012, the *Daily Telegraph* reported that 1,500 square miles of open countryside would have to be built on to solve a 'massive housing shortfall'.[11] You will consider some social issues when you look at life events in

[11] Christopher Hope, 'Government minister warns: "We must develop a third more land" to meet housing demand', *The Telegraph*, 27 November 2012.

Chapter 16, for example the problem for young couples buying their first house. Shortage of housing has fuelled property prices and rents have gone up, particularly in London. This is also an economic issue: prices are dependent on supply and demand, which we will consider in Chapter 14.

The stadium will need to fit in with this development. The Mayor of London has said that it will remain in public ownership, and bids for the lease have been received from four football clubs and from Formula One racing. You can give your opinion on the suitability of these bids. Will the athletics track be preserved? (Yes, according to the Mayor of London.) The future of British sport and especially school sport has been highly topical recently. (Incidentally, do you know who the current Mayor of London is?)

You could look at the transition from public to private ownership of the site. Responsibility for the development lies with the London Legacy Development Corporation (LLDC), which describes itself as 'a public sector, not for profit organisation' (a quango), set up after the Olympics by the Mayor of London.[12] There are a number of private and public companies involved in the development of the site. This will be a valuable boost for the construction industry. Can you talk with confidence about the public sector, not for profit organisations, or the difference between public and private companies?

Where will the money come from? The LLDC is looking for private as well as public finance, and has asked for pension fund investment amongst other sources. What do you know about investment and pension funds?

You could talk about what has happened to the Athens and Beijing stadiums after the 2004 and 2008 Olympics. These turned out to be white elephants. The Athens stadium, which was occasionally used for concerts, has fallen into disrepair, partly as a result of the euro and Greek government debt crisis. This gives you an opportunity to show that you can put seemingly unrelated issues into the wider economic context.

Chapters 14 to 16 are intended to provide the answers to some of these questions. You may not need the information all at once, but at some point either during your studies, when you go through the application process, or when you start a job, you will. As your career develops, you will need to adapt your knowledge for different clients, different firms, and as the world changes. The topics covered in this chapter are a starting point. If you look at some of the 'Thought-provoking questions' at the end of these chapters, they will give you an opportunity to practise this sort of analysis once you have read these chapters.

13.1.2 **Why you need it**

Building up commercial awareness cannot begin too early. It is relevant from the beginning of a degree course and into practice.

Studying

Having a level of commercial awareness can help to contribute to an understanding of various areas of black letter (academic) law.

12 http://www.londonlegacy.co.uk.

Example 2

Take contract law: it is sometimes said that 'Contract follows the money'. If you look at some contract cases, you can see that an understanding of the economic context at the time throws light on these. In the 18th century, Britain's wealth was based on its maritime trade: many 18th-century cases involve ships. Until the 20th century, a person's main asset was often his horse: there are a huge number of cases involving horses. In the 19th century, the advent of the railway transformed Britain—leading to a number of railway cases. In the 20th century, technology has transformed the economy: suddenly, computers became the subject of some very important cases.

Employability

As you have seen in Chapter 12, from the moment you start applying for a training contract, employers will want to know that you are tuned into the wider world, that you have the ability to meet your clients' expectations and add value to your legal advice. They will expect you to know the law, but you have to show that 'edge' which sets you apart from other applicants. Chapter 12 explained the process, but we are going to consider this from a commercial perspective.

1. The first hurdle is the application form. Application forms will contain questions that are designed to test your commercial knowledge. You have already looked at the 2010 BP oil spill example as a good illustration of the sort of commercial understanding which will help to make your application stand out.
2. Once you get to an interview or assessment day, the questions will take this a little further. The Olympic stadium question is an example of how to use a seemingly non-commercial question to demonstrate some commercial knowledge.
3. Finally, you will be expected to have an insight into the firm itself, its structure, its position within the market, and who its clients are, and their position within the market in which they operate, so you will need to do some detailed research before you go. We will look at the sort of information you are looking for in Chapters 15 and 16.

Example 3

You have an interview with a commercial firm. You have researched the firm and its clients and know it acts for a number of manufacturers whose main export markets are in Europe. You are asked to comment on the impact of the euro zone crisis. Let's assume you have some idea about the economic causes and the consequences. However, you will impress your interviewers more if you relate these to the firm's clients, commenting on the disadvantages of a strong pound for exporters. You could ask whether the clients are considering or in a position to expand into new markets, such as the growing markets of Brazil, Russia, India, and China (the **BRIC** economies) especially now that the euro is in trouble.

Practice

Once you get into practice, you will see that law firms are businesses (see Chapter 15). A lawyer has to understand how businesses work. The partners of the firm will expect it, so that the lawyer can contribute to the success of the firm, and the clients will expect it, so that the lawyer can contribute to their business and financial success. We all know that the world of work is an increasingly competitive environment. Working as a lawyer is no exception. You need to stand out from the crowd by showing skills over and above your legal knowledge. One of the ways that you can do this is by demonstrating commercial awareness.

13.1.3 **How to get it?**

So how do you develop (and show that you are developing) commercial awareness? Much of this has been covered in Chapter 6, but we are now going to put a commercial slant on this.

Skills

Commercial awareness is often about people, your clients, and managing their expectations. The legal skills that you will be covering on your journey to becoming a lawyer, such as interviewing and problem-solving, are designed to help you to learn to do that and to improve your communication skills, both oral and written. This will all help you develop successful professional relationships as well as improving your ability to give effective advice.

Research

It is not just legal research which is going to further your career. You need to know about economic, social and political, and technological, as well as legal issues. You should:

- Read the quality daily newspapers—*The Times*, *The Guardian*, the *Daily Telegraph*, and *The Independent*—particularly the financial pages.
- Watch the television news. Listen to news items on the radio. As understanding develops, it is important to look at more advanced subject matter by reading *The Financial Times* and *The Economist*, and watching and listening to programmes which analyse economics and finance, like *Newsnight* or the *Today* programme.
- Be aware of what is going on in the legal press. *Legal Business*, *The Lawyer*, and (for students and trainees) *Lawyer2B* magazines are excellent sources of legal news, and help you to understand law firms as businesses, and the context within which they are operating. Although these should be used with caution, websites such as RollonFriday (RoF)[13] and Legal Cheek[14] provide legal 'gossip' and comment on law firms (including the salaries they pay) and the legal profession. They can be a useful source of information and give a further perspective on topical issues. RoF has a jobs database and provides other recruitment assistance.

Work experience

However much anyone reads, there is no real substitute for working in a commercial environment. Vacation placements in law firms or pro bono work with organisations such

13 http://www.rollonfriday.co.uk. 14 http://www.legalcheek.com.

as the Citizens Advice Bureau show commitment to the legal profession, and will inevitably help to develop commercial awareness. However, it is not just legal jobs which help to improve commercial know-how. Working for any business gives an insight into how businesses work, how they deal with money, and gives experience of working as part of a team as well as client/customer relationships. If you think about it, a job in a local supermarket teaches all these things in the same way as a job in a city bank. Law firms recognise such skills as transferable, that is provided you are able to demonstrate that you have acquired these skills, and how, they are less concerned about the context in which they have been acquired.

Networking

You have seen in Chapter 12 that networking is a crucial skill. Students should always use any contacts which they may have, particularly parents, friends' parents, and their friends. Most of them will have worked in some sort of commercial environment for years. Students can pick their brains to find out what the trends are within their businesses, what factors are influencing their business decisions, their customer/client experiences, and what contributes to success or failure.

Opportunities

Colleges or universities will usually arrange seminars and talks on subjects that are relevant to commercial awareness. There will be clubs and societies which help to develop this. Students should always make the most of these opportunities. It can all go into a CV.

13.2 Types of business structure

We will now follow through the BP example at 13.1.1 and start by giving you some of the information you need to demonstrate that you understand the business environment, and how businesses operate. Our starting point is business structures. There are five main types of legal business structures, which are illustrated in Figure 13.2:

1. Sole traders.
2. Partnerships.
3. Limited liability partnerships.
4. Private companies.
5. Public companies.

In every high street in every town in the country, there is a huge variety of different types of business of various sizes, operating in several sectors: retail, professional services, banking, and hospitality—cafes, restaurants, and bars. We will now use the high street as a model for considering the advantages and disadvantages of these different business structures.

It is crucial to understand that not all businesses are companies. The term business covers a wide range of business structures, each of which has its own legal status, which affects its conduct and performance. We will start by looking at some general principles.

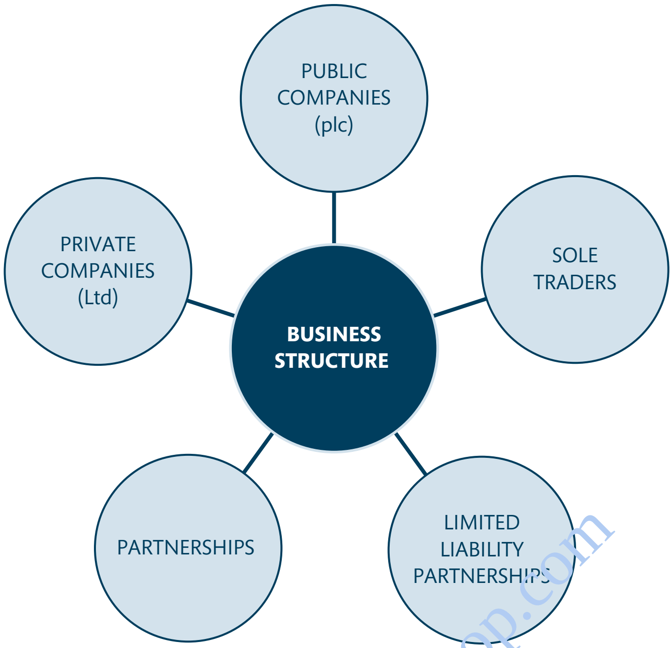

Figure 13.2 Types of business structure

Essential explanation

Businesses can be either **incorporated** or **unincorporated**

1. An incorporated business must undergo a formal registration process before it is set up and before it can 'legally' exist. The most common examples are private limited companies, public companies, and limited liability partnerships.
2. An unincorporated business is not required to follow any formal process in order to be set up. All the owners need to do is open the doors and start trading. Unincorporated businesses include sole traders and partnerships.

13.2.1 **Legal personality**

Essential explanation

Legal personality consists of a 'bundle' of legal rights and duties imposed by the law which govern every aspect of the lives of individuals or incorporated businesses. These rights and duties dictate their legal status.

Whether a business has its own legal personality depends on whether it is incorporated or unincorporated.

1. Unincorporated businesses have no legal status of their own. If the business fails, it is not just the business assets, such as the premises, stock, and shop fittings, but the owner's

personal possessions, such as her house, car, and savings which may be taken and sold to pay outstanding debts. If she cannot pay, she may be made bankrupt. This is known as **unlimited liability**. In addition, partners have 'joint and several' liability. Effectively, the actions of one partner can mean that the others could lose their house, car, or other assets, and in a worst-case scenario be made bankrupt. There is an old adage that you should 'choose your [business] partner more carefully than your spouse'.

2. Incorporated businesses do have their own legal personality, which gives them an independent legal existence, entirely separate from their owners. If the business fails, the owners lose the money which they have invested in the company, but no more. They cannot lose their personal assets in the same way that sole traders or partners may. This is known as **limited liability**.

In a famous case,[15] Lord Denning compared a company with a human body. Like a person, he described a company as having a brain and a nerve centre—the board of directors—which controls the entire body. The employees are their hands, and they carry out the instructions of the 'brain'.

13.2.2 **Sole traders**

The smallest, and most common, type of business entity is the sole trader. As the name suggests, this type of business is owned by just one person. Sole traders are the largest group of businesses in the UK. The Department of Business, Innovation and Skills (BIS) estimates that there were approximately 3.0 million sole traders operating throughout the UK at the start of 2012; 2.7 million of which had no employees.[16]

A sole trader may have a few employees but, according to the BIS statistics, over 75% have no employees at all (these are called **class zero businesses**). Most sole traders operate in the service sector: plumbers, builders, small retailers, and professionals. For example, on a typical high street, it is likely that the gift shop, butcher, and perhaps the accountant are run by sole traders. Table 13.1 shows the advantages and disadvantages for sole traders.

Table 13.1 Advantages and disadvantages for sole traders

Advantages	Disadvantages
Set up: A sole trader can set up with minimum administrative steps (the only thing that he will need to do is to inform the tax authorities (HMCR) for tax purposes).	**Start up costs:** The owner will be solely responsible for the start up costs.
Regulation: Sole traders are free to run the business as they wish. Day-to-day record keeping is unregulated and comparatively simple.	**Debts:** The owner is personally liable for all the debts of the business.
This is a good way to test the market for the new business.	**Expansion:** The owner must find the funds to expand the business himself.
	Management: The owner is responsible for all management decisions, and will have little support.

15 *HL Bolton Engineering Co. Ltd* v *TJ Graham & Sons Ltd* [1957] 1 QB 159.
16 BIS, *Business Population Estimates for the UK and Regions 2012* (17 October 2012).

13.2.3 Partnerships

For a partnership to exist, two or more people must own the business. For example, a boutique on the high street which is run by two friends will automatically be a partnership (unless they have set up a company). Partnerships are found in the same sectors as sole traders. They are particularly common in the professions. As well as the boutique, firms of solicitors, estate agents, or accountants could be partnerships, and it is equally possible that a gift shop or a butchers shop could be. The BIS figures show that there are nearly 450,000 partnerships in the UK. Over 60% consist of the partners only with no employees. Some of the City law firms on the other hand have over 100 partners and over 1,000 employees. Compare the advantages and disadvantages of sole traders with those of partnerships, as shown in Table 13.2.

13.2.4 Companies

Again, there is a wide range of company types, both in size and in the services they provide. There are about 2.7 million companies registered in the UK, with an estimated annual turnover of £2.9 trillion. Of these, 8,378 are public companies.[17] We have already looked at BP, Royal Dutch Shell, and Exxon Mobil as an examples of large multi-national companies. Most companies, however, are much smaller, employing fewer than four people. 41% of all limited companies have no employees, and are managed and run by a sole director. Now compare sole traders and partnerships with the advantages and disadvantages of setting up a company (Table 13.3).

Table 13.2 Advantages and disadvantages of partnerships

Advantages	Disadvantages
Set up: Partnerships can be set up with minimum formalities and administrative steps (apart from advising HMRC for tax purposes). A partnership agreement is advisable, but not required.	**Profits:** All profits belong to the partners, and are shared between them.
Regulation: Partners are free to run the business as they wish. Day-to-day record keeping is unregulated and comparatively simple.	**Debts**: The partners will be personally liable for all the debts of the business.
Management: Partners share management decisions, and each partner can specialise in, and concentrate on a particular area of the business, although with too many partners, decision making can be cumbersome.	**Joint and several liability:** If one partner cannot pay his share of the debts, the other partner or partners can be personally liable for that partner's share (as well as their own) from their own personal assets.
Start up costs: The partners will share the start up costs.	**Borrowing:** The partners must personally service all loans.
Expansion: With more owners, more finance can be raised so expansion is easier. If more money is needed, more partners can be brought in.	**Uncertainty:** If no partnership agreement has been entered into, this can lead to uncertainty.

17 Companies House, *Register of Business Statistics*, http://www.companieshouse.gov.uk/about/businessRegisterStat.shtml.

Table 13.3 Advantages and disadvantages of setting up a company

Advantages	Disadvantages
Debts: Owners have limited liability so are not personally liable for the debts of the company.	**Setting up:** Companies must register with Registrar of Companies and obtain a certificate of incorporation.
Start up costs: Finance will be raised by issuing shares or borrowing.	**Profits:** Profits are shared between the shareholders.
Management: Board of directors responsible for day-to-day management	**Management:** Directors have extra legal duties and may be liable if these are breached.
Expansion: Further finance raised by issuing more shares or borrowing, which will be more readily accessible.	**Regulation:** There are ongoing regulatory requirements which must be complied with, e.g. companies have to file their annual accounts at Companies House, so financial information is made public.
Loans: Shareholders are not personally liable for servicing loans.	

13.2.5 **Limited liability partnerships**

A limited liability partnership (LLP) is basically a hybrid between a partnership and a limited company. Like a company, it must be incorporated, and as a result, it has its own legal personality separate from its owners. The owners are not personally liable for its debts, but it is run like a partnership. As with a partnership, there must be two or more people. There are approximately 45,000 LLPs in the UK. Many larger LLPs are professional firms (e.g. solicitors or accountants). Two of the largest LLPs are Clifford Chance LLP and Linklaters LLP, the City law firms. It is possible that your nearest high-street solicitors are an LLP.

13.2.6 **Private and public companies**

Essential explanation

A **public** company can offer its shares to the public. 'Public' does not mean that it is a nationalised company owned by the government; these companies are known as **publically owned** companies. Examples of the latter include Royal Bank of Scotland and Northern Rock which the government rescued in 2008/9 to prevent their collapse. Conversely, **private** simply means that the company is not public and so it cannot make a public offer of its shares, which must be sold privately.

Private limited companies (ltd)

Most companies in the UK are private limited companies, many being small family concerns, such as hardware stores and hotels.

It is possible for a private company to be owned by a single shareholder and managed by a single director, usually the same person. Equally they can be large national companies. Richard Branson's Virgin Group Ltd is a private company. You can easily spot whether a company is a private company by looking at the name: a private company will have the abbreviation 'Ltd' for 'limited' after its name.

Public limited companies (plc)

A company has to comply with various statutory requirements to qualify as a public company. The most important is that it must have a specific amount of share capital, currently £50,000 or more. Again you can tell whether a company is a public company by looking at the name. You will see the abbreviation 'plc', for example, Marks & Spencer plc or Next plc.

A public company may be quoted, or listed, on a **stock exchange** in the UK. Private companies cannot be. There is no obligation on a public company to join a stock market. A company does not start out as a listed company. Companies tend to start small, expand, and once they reach a certain size, reputation, or level of growth, then they apply. To join the Main Market, a company must successfully complete a time-consuming and complicated procedure, known as a '**flotation**' or '**IPO'** (Initial Public Offering), but the rewards can be huge. (We will look at how the stock market works in Chapter 14). See Example 4.

> **Example 4**
>
> A recent high-profile example is the Facebook flotation on the New York NASDAQ exchange. Shares in the company were offered to the public at $38 each, and this meant that the company was valued at $104.2 billion. Caught in the hype of the largest IPO in history, investors flocked to buy. Mark Zuckerberg and the co-founders of Facebook become billionaires overnight. Within three days, the value of the shares had fallen by 15% and shareholders are suing Zuckerberg, Facebook, and the bankers involved in the IPO.[18]

13.2.7 **Who owns a company?**

When a company is set up, the owners buy shares in the company, and become, not surprisingly, the **shareholders** or '**members**' of the company. When someone buys shares, there are two results:

1. She owns a fraction of the assets of the company as each share represents a share of the ownership of the company. Shares also represent a fractional entitlement to the capital value of the company. The more shares owned, the greater the entitlement of that shareholder if, for example, the company was to be sold and its assets distributed to its shareholders.
2. She is entitled to receive a share of the profits. The amount of profit which she will receive depends, again, on how many shares she owns. The payment of profit which each shareholder receives is called a **dividend**.

Note that shareholders are not necessarily **directors**. There is no obligation on a shareholder to be a director. There is a distinct division between the roles and responsibilities of the two groups, which we will look at in 13.3.1, when we consider how companies are managed.

[18] 'Facebook founder Mark Zuckerberg sued by shareholders over IPO', *Daily Telegraph*, 23 May 2012.

13.2.8 **Other classifications**

Multi-national companies

A multi-national company is a company which trades worldwide and is quoted on more than one stock exchange. CocaCola and McDonald's are probably two of the best-known examples. On the high street, Barclays is a multi-national with operations in 50 countries, 140,000 employees, and it is listed on the London and New York stock exchanges. Starbucks has 18,887 stores in 55 countries, but does not meet the true definition of a multi-national as it only listed on one stock exchange in New York, the NASDAQ.

Micro, small, and medium sized enterprises

At the other end of the scale are **micro enterprises** and **small and medium sized enterprises** (**SMEs**). BIS defines these as businesses which have between 0 and 249 employees. 99.9% of all businesses are within the definition, and they account for 48.8% of all private sector turnover.[19] They include sole traders, partnerships, and companies. Historically, they have been responsible for stimulating the economy and driving competition. One of the side-effects of the credit crunch has been that many such businesses have been unable to get loans and investment to grow effectively, and thus have not been able to fulfil this function fully.

Groups of companies

Increasingly, companies are formed into groups. There is a **parent** (or **holding**) company and **subsidiary** companies, which together form one single economic entity. The subsidiaries are controlled by the parent. The parent company has a majority shareholding (51% or more) in the subsidiary and a right to appoint its directors. Figure 13.3 shows a typical group relationship.

Examples on the high street include Burton (a subsidiary), which is part of Sir Philip Green's Arcadia Group (parent company), which also includes Top Shop and Miss Selfridge (subsidiaries). Costa Coffee is a subsidiary of the Whitbread hotel and restaurant group (parent). Pizza Express (subsidiary) is part of the Gondola Group (parent). In other words, many successful, better-known companies are part of a larger group.

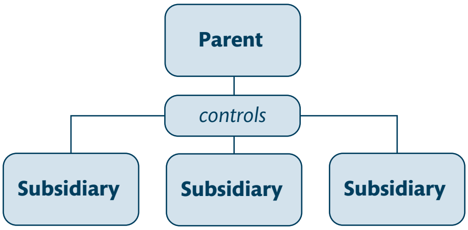

Figure 13.3 A group of companies

19 BIS, *Business Population Estimates for the UK and Regions 2012* (17 October 2012).

Franchises

A franchise is where a business (the '**franchisor**') allows third parties ('**franchisees**') to use its name, concept, business format, and experience in return for payment. In particular, the franchisee can use the franchisor's intellectual property rights. Unlike a corporate group, where the parent controls the subsidiary, the franchisor does not own the franchisee, but has a contractual agreement which obliges the latter to operate in a particular way.

Franchising is becoming increasingly popular, and you will find franchises in various sectors. Well-known examples include McDonald's, KFC, and the Body Shop. If you go to McDonald's in any city in any part of the world, the restaurant set up is the same, the food is the same, the price is the same, and everything is sold under the McDonald's brand.

A franchise offers a franchisee a relatively cheap and comparatively risk-free way of opening a business, without starting from scratch. The franchisee is able to use a business concept which has been proved to work and an established brand. For the franchisor, franchising can also be a way of expanding into new or unfamiliar markets. For example, Next plc has 50 franchises throughout Europe, Asia, and the Middle East.

13.2.9 **Which is best?**

The role of the solicitor will be to advise a client who is setting up in business on the advantages and disadvantages of each type of business structure, but it will be up to the client to decide which is best for him, bearing in mind the advantages and disadvantages of each.

Commercial awareness, as we have seen, is not all about law and facts. Before a client makes a decision, it is important that he considers all the practical consequences of starting up a business. Examples of further factors which he should think about are:

1. **The economic climate**. Is this the best time to start up a business? What will be the effect of the continuing euro zone crisis?
2. **Personal factors.** Setting up a business is stressful and uncertain, not just for the client but for his family. Is he (and are they) ready for this?
3. **Change of lifestyle**. It takes commitment and motivation to get a business up and running. Is he ready to work long hours and weekends?
4. **The financial implications**. How will he manage financially before the business starts to earn money?
5. **The need for a new skill set**. How good is the client at financial planning, managing employees, logistics, marketing, and sales?
6. **Business plan**. Has the client got a business plan? Has he got the support of his bank/ small business adviser?

13.3 Business organisation and management

Your client may be a business but a business is run and managed by people—they may be very high-powered business executives, like Richard Branson of Virgin, or they may have limited business experience, like a plumber running a small business in a local town.

It is often said that vets have highly stressful jobs because not only do they need to be able to treat the animals effectively, but they also need to deal with the concerns of their owners. As a lawyer, acting for a business is similar. Lawyers need to know the law and advise on what is best for the business. However, lawyers are dealing not with the business itself (which, after all, is inanimate), but with a variety of individuals involved in business, such as the directors or managers of a company, or the partners of a firm. These are the people you will be dealing with on a day-to-day basis, and being a successful lawyer involves building good relationships with them. One of the things you need to know is what the people you are dealing with do within their organisation. They will not be impressed if you do not. Again, as we have seen from Case study 1, this background will help you at interviews and assessment days.

In this section, we will look at the management structure of businesses, and how they organise and plan their operations, concentrating particularly on larger public companies. Although management techniques and concepts are outside the scope of this chapter, we will cover some of the more important, so that you have an idea of the underlying rationale of company organisation, and understand some of the (sometimes seemingly incomprehensible) jargon used by those involved in management of companies.

13.3.1 **Companies**

We have already seen that there is a distinct division between the role of directors and the role of the shareholders. Shareholders do not need to be directors of the company and directors do not necessarily have to be shareholders, although often they will be required to do so by the company's constitution.

Directors

The directors take the day-to-day decisions on the running of the company at **board meetings**.

Directors have certain legal duties which ensure that they act in the best interests of the company and the shareholders, and do not take advantage of their position for their own benefit. In addition, there are certain things that they cannot do without the consent of a majority of the shareholders, for example, they cannot take a loan from the company. If directors or officers of the company are found to be in breach of their duties, they can be held liable.

Shareholders

The shareholders, although they are the owners of the company, do not take part in the day-to-day running of the company. In theory at least, they take the more important decisions affecting the company, because they are entitled to attend and vote at **general meetings**. In fact a majority of shareholders, particularly shareholders of public companies, never attend such meetings and take no part in the running of the company.

Public companies, but not private companies, have to hold an **annual general meeting** to allow the shareholders to elect new directors and question the directors on the annual report. The annual report is a report to the shareholders on how the company has performed during the year, and their plans for the following year. Again, most shareholders do not attend or vote. However, some do.

Example 5

The spring of 2012 saw several shareholder rebellions (collectively dubbed the 'Shareholder Spring' after the Arab Spring uprisings of 2011) against excessive executive pay rises at some top companies. At Barclays, where 27% of shareholders voted against CEO Bob Diamond's £17 million pay package, this was not a high enough percentage to succeed. However, at the AGM of the insurance company, Aviva, over 50% of shareholders blocked a pay rise for its CEO, who subsequently resigned, and shareholders at AstraZeneca, the pharmaceutical company, forced their CEO to resign after the company published poor financial results. In the long term, however, this has had a limited impact.[20]

13.3.2 **Differences between private and public companies**

Public companies by their very nature have far more complex management structures than private companies.

Private companies

Private companies have a board of directors which carries out the day-to-day management of the company. A private company may have just one director (a public company must have at least two). The shareholders of a private company are more likely to be the directors, but this will not necessarily be the case. For example, when a client sets up a company, he may issue shares to both himself and his wife. He will act as a director, but she may play no role in the running of the company.

Public companies

Figure 13.4 shows the hierarchy of the management structure for a plc. Like a private company, there will be a board of directors who will be responsible for decisions affecting the day-to-day running of the company. The board is also described as the **executive**, as it 'executes' decisions on behalf of the company.

Head of the board is the Chief Executive Officer (CEO). (CEO is a US term which is gaining popularity in the UK; you may also see the CEO referred to as the Managing Director (MD)). There may also be a Chairman above the CEO. The Chairman is often a figure-head, and acts in a **non-executive** or advisory capacity.

The board is responsible for strategic planning which sets the goals and objectives of the organisation. Below the board will be the managers of the company who are responsible for carrying out the board's decisions, and ensuring that the goals and objectives are achieved, through organisation and planning. In other words, they manage and organise the next level, the workforce. This gives a **cascade** effect. Decisions start at the top and cascade down towards those whose role it is to implement them. This is illustrated in Figure 13.4.

[20] Ruth Sullivan, '"Shareholder spring" muted', *FT.com*, 26 August 2012, http://www.ft.com.

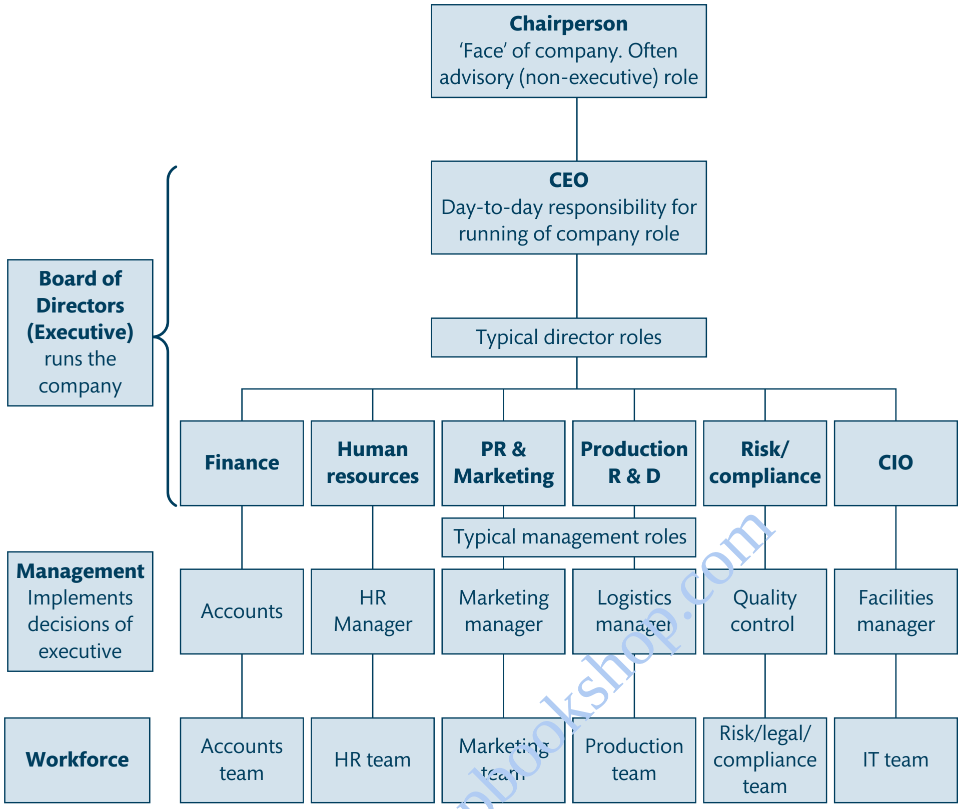

Figure 13.4 Management structure of a public company

Typical roles which directors may have include:

- **Finance** Director, who is responsible for all the financial decisions for the company. This is the most important role after the CEO. The **finance** or **accounts** department which she oversees is responsible for everything to do with money, for example the funding of the business, investment, paying suppliers, and ensuring that customers pay.
- Director of **Human Resources** or **People**, who takes decisions in relation to staffing, employment issues, and all other decisions affecting the workforce. His department's responsibilities include payroll, holidays and sick leave, performance, and disciplinary procedures. He will draft and implement company policies.
- **PR** or **Marketing** Director, who is responsible for promoting the company, dealing with customers, promotions, branding, and public relations. The PR department is responsible for dealing with the press and building the company's public profile.
- The **Sales** Director is responsible for actual sales to customers and account management.
- **Chief Information Officer (CIO)**, who is responsible for all the information technology. The ICT department deals with communication issues and the functioning of computers, networks, and telephones.

- **Research and Development** and **Production** Director, as the name suggests, will be responsible for the development and quality of products quality. He has to ensure that products are produced as efficiently as possible and have a technological advantage, putting the company ahead in the market place
- There may be a **Logistics** Director. Logistics is the modern term for procurement (purchasing), distribution, and related activities (see 13.4.4).
- **Risk management** is identifying the sorts of risks (or things that can go wrong) in a particular business, and ensuring that systems are put in place to avoid or mitigate these as far as possible. Those responsible for **compliance** ensure that the company meets all regulatory requirements for that particular business. They are often lawyers. There may be a separate **Legal Director**.

In an efficient organisation all these functions will be coordinated to ensure the smooth running of the company and, crucially, to develop the strategy of the company.

13.3.3 **Sole traders and partnerships**

We have seen that sole traders and partnerships are managed by their owners, who have the responsibility for the day-to-day running of the business.

In professional partnerships, often the senior partner will have overall management control, and act as the equivalent of the CEO of a company. Traditionally, this role has gone to the longest serving partner, and only became available when a senior partner retired. However, as management has become more challenging, length of service has not necessarily provided the necessary skills for the job. Good lawyers are not always good managers.

In law firms, larger partnerships and LLPs will often have a **managing partner**, who will have overall responsibility for the management of the partnership. The managing partner will oversee all the management roles mentioned above in relation to companies, personnel, finance, marketing, and so forth. A recent article in the journal *Legal Business* reported that this is not always an easy task. Lawyers tend not to be easily managed, and are often resistant to change. 'Lawyers are worst because they think they know best.'[21] Large city firms such as Linklaters, Lovells, and DLA Piper have tried to resolve this by sending their managing partners to Harvard Business School,[22] but clearly this is not going to be an option for all firms.

13.3.4 **Strategies and objectives**

Once you know how a business works, and who has responsibility for its management, it is important to know what it is hoping to achieve.

[21] Dominique Graham, 'It's a tough job...5 reasons not to be a managing partner', *Legal Business*, July/August 2005, http://www.grahamgill.com/pdf/GG-A_tough_job.pdf.

[22] Ravinder Casley Gera, 'Business Schools for Lawyers', *The Chambers Magazine*, Issue 25, 2008, http://www.chambersmagazine.co.uk/Article/Business-Schools-for-Lawyers.

Strategies

Business organisations, both large and small, should have a strategy.

Essential explanation

A **strategy** sets out a long-term plan of what the business wants to achieve (its **vision**) and how it proposes to achieve it (its **mission).** You will sometimes see strategies referred to as the 'roadmap' for the business or its 'game plan'.

An organisation's vision and mission statements are usually published on its website, for example Microsoft, whose mission is to be 'the world's no 1 provider of innovative technical solutions'[23] and Coca Cola, whose mission is to 'refresh the world ...'.[24]

These statements are closely allied to the organisation's **values and ethics**. When explaining its strategy, the organisation may state its values and/or culture, emphasising what makes a company unique within a particular market, or what binds it together. Taken together, the statement of values and the vision and mission statement set out **why** the company is in business.

Millions of pounds are spent by businesses developing strategies in order to improve their competitiveness within the market in which they are operating. However, there is no point in having a strategy if you cannot get your workforce to buy into it, or effectively communicate this to potential customers. The idea of a strategy is to motivate the workforce, which in turn will bring in customers and investment. In other words, the strategy needs to be effectively communicated and implemented. It is more likely to work in a business where everyone knows **what** they are required to do to achieve the strategy, **how** they are supposed to do it, and **who** is going to ensure that it is done.

If you go back to Figure 13.4 showing the management hierarchy, you can see how this can be achieved by a company.

- **Why**, the vision, mission, and values, is decided by the directors.
- **What**, the objectives, or targets of the business, again will be set by the directors.
- **How**, the tactical decisions how this is to be achieved are made by the management.
- **Who** is the workforce, which implement the tactics.

The relationship between each of the various levels should be clear so everyone knows who is responsible for, and to, whom. A business may have an **organogram**, which is a diagram showing the structure of the organisation and the interrelationship between directors, management, and the workforce. Figure 13.4 is a simplified organogram. If you are acting for any organisation, you will often find it useful to see its organogram, as it will clarify the role of the people you will be dealing with.

[23] http://www.microsoft.com/about/diversity/en/us/vision.aspx.
[24] http://www.coca-colacompany.com/our-company/mission-vision-values.

Objectives

Essential explanation

An **objective** is a target. It is different from a strategy in that it is more concrete and immediate.

The target of many businesses is to make or increase a profit, for example increase profit by 10% per year for the next five years, or to achieve 50% return business. In order to ensure that targets are met they have to be achievable. Managers often use the SMART model in relation to objectives. You have already considered this in the context of a presentation, but the model has a range of applications, and is frequently used by business organisations. Objectives are SMART if they are:

- **S**—specific (clear and unambiguous)
- **M**—measurable (capable of being measured against objective criteria)
- **A**—achievable (can be accomplished by the workforce)
- **R**—relevant (suitable for and of appeal to the workforce)
- **T**—time-appropriate (achievable within an agreed time frame)

13.3.5 **Analysis**

A further role of management is analysis of its position within the market place. A variety of management tools are used, which you may also find useful in other situations. For example, if you are preparing for a negotiation, you can use a SWOT analysis to organise the information which you have, or you can use it when you research an organisation when you are looking for a job.

SWOT

Essential explanation

SWOT is a management tool used to examine the strengths (S) and weaknesses (W), opportunities (O) available, and threats (T) confronting the business. **Strengths and weaknesses** are factors which are **internal** to the firm or business, whereas **opportunities and threats** relate to **external** factors. The results are usually shown in a grid form (see Figure 13.5).

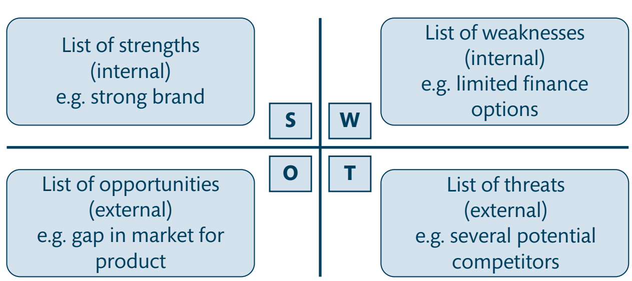

Figure 13.5 SWOT analysis grid

Using SWOT provides useful information for managers on the current position of the business and allows them to determine what their future priorities will be. It can be used on the business, its customers, or competitors. It is usually done when some change in business operations is likely, such as bidding for new customers, or expanding into new markets.

PESTLE

Just like the professionals who advise them, the owners and managers of companies need to think about the context in which they are operating.

> **Essential explanation**
>
> **PESTLE:** political (**P**), economic (**E**), social (**S**), technological (**T**), legal (**L**), and environmental (**E**) changes that affect commercial activity.

All businesses are affected by changes brought about by these factors. They must take advantage of the opportunities offered and respond to the challenges and restrictions which they may impose. For example, political factors include the stability of the government, and its tax policy etc. Similarly, economic factors to be considered would include interest rates, the level of inflation, unemployment, projected economic growth or decline. Social factors include population growth rate and demographics, for instance the ageing population, social mobility, and public opinion. Technological issues include new ways of working and communication. Legal issues include trends in regulation and deregulation or employment legislation. Environmental issues are factors such as weather and climate change.

In Chapter 16, we look at a business case where a client is thinking of setting up an off-licence. There are concerns about binge drinking amongst young people and the increase in alcohol consumption amongst middle-aged professionals and the ensuing health problems. There is increasing debate about whether or not the government should intervene and legislate to restrict, for example, the opening hours of pubs, clubs, and off-licences in town centres. So a social concern will lead to political intervention and consequent legal constraints. The easiest way to control alcohol consumption is to increase the cost of alcohol by increasing taxes on all types of alcoholic drinks, making this an economic issue as well. All of this is bound to have an effect on the client's business. He will also need to think about the impact of technology.

Technology and social networking

We have seen that advances in technology have posed a significant threat particularly for smaller law firms. One of the challenges for any business is to harness and drive technology for its own ends. Whereas in the past, businesses had to go out and find customers, now the internet provides a forum for customers to find them. The development of cloud computing and the growth of social network sites like Facebook, Twitter, and LinkedIn have opened up important opportunities for businesses. The importance of social networking cannot be underestimated, perhaps illustrated by the fact that lawyers are beginning to consider what you should do with your 'digital assets', including your passwords, when you die.[25] The next opportunity could be a 'mouse-click' away. The marketing potential is immense. Facebook has 750 million users, 50% of whom log in every day. A survey has shown that 48% of small businesses are using social network sites to expand and grow:[26] 26% of those use Facebook, 25% use LinkedIn, and 21% use Twitter to promote their businesses.[27] Social networks provide infinite marketing opportunities. US corporations are increasingly setting up social media 'hubs' so that they can manage and respond to social media. A further benefit is that rather than the traditional recruitment process, social networks provide links to potential employees.

The accessibility of social networking sites works both ways. US employers are reported to be routinely asking interviewees for their Facebook logins so that they can check their profiles before making job offers.[28] Example 6 can be a warning to you of the power of social networks.

Example **6**

After leaving University, Charlotte started looking for jobs as a PA. She had two successful interviews with a leading London property firm. The second interview went well and she was expecting to be called for a third interview. She heard nothing, and contacted her recruitment agent for feedback. She was told that she had interviewed well, but it was very unfortunate about the Facebook photograph. One of her friends had sent her a photograph of a lap dancer, to whom Charlotte bore an uncanny resemblance. Charlotte had posted this on Facebook, and jokingly changed her profile from unemployed to 'lap dancer'. The 'joke' had cost her the job.

13.4 **The business environment**

We now look at another important economic concept: markets and sectors. When we looked at the BP case study (see Case study 1), we saw that BP operated within the 'energy sector'. When we look at law firms, we will talk about the 'legal market'. The very act of selling goods or services creates a market. Businesses sell those goods and services to make money, and to make money they need to get as many buyers, or consumers, of the product as possible. The result is that within any market or sector businesses compete between themselves to be the biggest or the best, so markets and sectors are important because they generate competition. Healthy competition is good for businesses, as it drives growth, and it is good for the consumers of their goods or service, as it means that there will be more goods and services available, and prices will be lower. This section will consider what we mean by sectors and markets, the role of consumers, how products reach those consumers (the supply chain), and the influence of competition in providing goods and services for consumers. All of these issues will help make sense of why the BP oil spill was such a disaster.

[25] Oliver Embley, 'What happens to our online assets on death', *The Times*, 6 November 2012.
[26] Regus, 'SMEs lead way in social networking for business' (27 June 2011).
[27] YouGov survey, October 2011.
[28] 'Facebook passwords "fair game in job interviews"', *Daily Telegraph*, 23 March 2012.

13.4.1 **Sectors and markets**

The problem here is to define what exactly we mean by these terms, because you will see them used in all sorts of senses.

Economic sectors

> **Essential explanation**
>
> An **economic sector** is a part or subdivision of the economy. It describes one of the areas into which the economic activity of a country is divided, and the proportion of the population engaged in particular activities.

There are four economic sectors:

1. **Primary:** extraction of raw material, such as mining, farming, or fishing. This is the oldest sector, as people have been engaged in farming since pre-historic times. Developed economies such as the UK or US will now have comparatively few workers involved in the primary sector.
2. **Secondary**: production, such as manufacture, construction, refining. There is a logical progression from extraction of raw materials to producing a finished product, like cars, houses, or textiles. The number of workers involved in manufacturing and related industries has declined in the UK in recent years, as more workers have moved into service industries. The decline of manufacturing industry is known as **deindustrialisation**.
3. **Tertiary**: provision of services, such as law, medicine, retail, entertainment, or tourism. This is the most important sector of the UK and other developed economies. As an economy develops, demand for services increases. The majority of workers in the UK are involved in the service sector, which accounts for about 75% of the UK economy.
4. **Quarternary**: research, design, and development, such as pharmaceuticals or computer programs. This is a comparatively new sector, but of increasing importance.

There is also a suggestion that there may be a fifth **quinary** sector, which includes workers who are involved in the highest decision-making processes, for instance top executives in media, culture, education, etc.

These are the main economic categories, but you will see further subdivisions. For example, energy, retail, industrial, hospitality, media, healthcare, financial, and so forth.

Public, private, and voluntary sectors

Public sector organisations, as we have seen, are those which are owned, financed, and controlled by the government. They provide services to the public, often free. Obvious examples are the National Health Service, or the BBC. The public sector is far wider than this and includes all central government departments, the central bank, local authorities, quangos, and government executive agencies. The London Legacy Development Corporation which is responsible for the development of the Olympic Park is a quango.

> **Essential explanation**
>
> A **quango** is a 'quasi-autonomous non-governmental organisation'. It is funded by the tax payer, but it is not controlled by central government. Quangos are topical as the government promised in 2010 to get rid of nearly 200 as part of its austerity initiative.[29]

By contrast, the **private sector** is made up of all businesses which are run by individuals and companies for profit, whether they be sole traders, partnerships, or companies.

Voluntary sector organisations are charities and other organisations, such as clubs, which are not run for profit.

13.4.2 Industries

You will also see reference to **industries** and **industrial sectors**.

> **Essential explanation**
>
> An **industry** is a group of businesses that produce the same goods, for example the electrical industry, the retail industry, or the pharmaceutical industry. These are then grouped into wider **industrial sectors**, for example the manufacturing sector, construction sector, or transport sector.

13.4.3 Markets

> **Essential explanation**
>
> A **market** is any place where the sellers of particular goods or services can meet with the buyers who want to buy those goods or services. They can be actual physical markets or they can be 'virtual' markets.

Ever since people started trading, markets have existed. The very width of the definition shows there are going to be lots of different types of markets. If you watch *The Apprentice*, you will see that Lord Sugar tests his candidates by introducing them to a variety of 'market' experiences, and seeing how they cope in each one.

- Actual physical **retail markets** can be any type of market from the local market held each week in any typical market town to large scale markets which cater mainly for business customers.
- **Geographic markets** range from global markets (where trade takes place with every country in the world) to regional (e.g. the European Union) or local markets (a

[29] '"Bonfire of the quangos" revealed', *Channel 4 News*, 14 October 2012, http://www.channel4.com/news/bonfire-of-the-quangos-promised.

small defined area within one country). They are hugely important in assessing the competitiveness of a business.

- **Emerging markets** are markets which are experiencing rapid economic, social, and business growth. The main ones are Brazil, Russia, India, and China, the BRIC economies.
- **Product markets** are determined by the exclusivity of a product or whether, if this product is not available, consumers will buy another product instead. This is called **substitutionality**.
- **Labour markets** are markets where employers can find workers or workers can find jobs.
- **Financial markets**, including stock markets, currency, and commodity markets, are considered in Chapter 14.
- **'Virtual' markets** exist only online.
- **Consumer markets** are where businesses sell goods or services to consumers. These sales are referred to as **B2C** (business to consumer). In the legal profession, a typical example is the provision of domestic conveyancing services for individual clients.
- **Industrial markets** are where businesses sell to other businesses, selling the sort of goods or services that consumers would not normally buy, such as raw materials or industrial components. These sales are referred to as **B2B** (business to business). Again, within the legal sector, a typical example is the advice provided by the corporate departments of large City firms, for example in relation to equity or debt finance, which are considered in Chapter 14.

We are now going to concentrate on the last two categories, consumer and industrial markets, and think about how the goods you buy end up in the shops.

13.4.4 The supply chain

If markets are about buying and selling, it goes without saying that there have to be goods and services to buy and sell. Someone has to manufacture goods from raw materials, put them on the market, and make sure they reach the people who want to buy them.

> **Essential explanation**
>
> The **supply chain** describes the steps it takes to get goods and services from a supplier to an end user, and includes every company that comes into contact with those goods in the process. Any break in the supply chain will cause shortages, and has the potential to increase prices.

One possibility is for a manufacturer to sell its goods direct to retailers, or wholesalers, who will sell on to other retailers or direct to the end user. This is, however, not the most usual arrangement, and often a 'middle man' in the form of either a distributor or an agent will be involved. Figure 13.6 shows a simple supply chain.

By looking at the diagram, you can see why the BP oil spill and the consequent shortage of oil (at the top of the supply chain) was such a disaster.

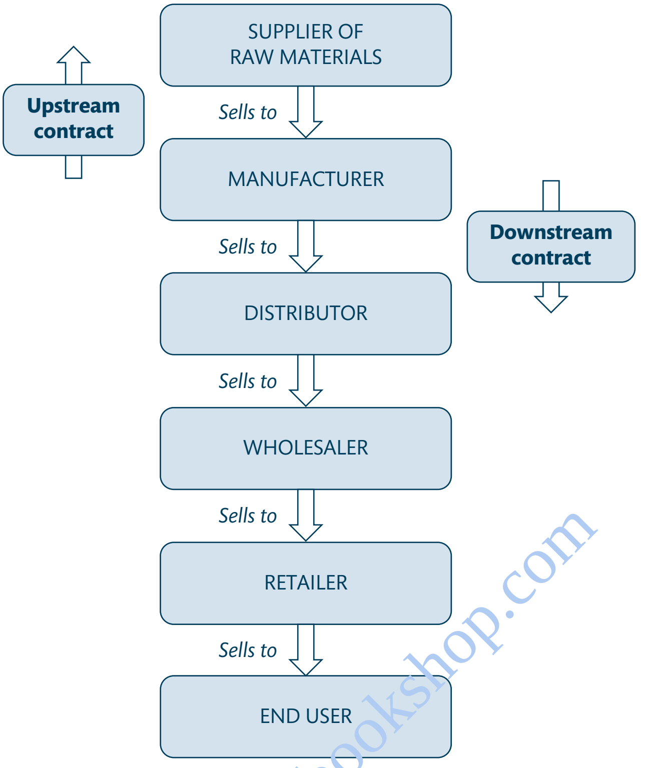

Figure 13.6 A simple supply chain

At the top end of the chain, the manufacturer will have two concerns:

1. First it has to produce the goods or services, its products, as efficiently and cheaply as possible. One aspect of the manufacturing process is the sourcing of the raw materials, services, and utilities necessary to produce the goods and enable the business to function effectively. Where necessary, materials have to be transported and stored. (This process is referred to as **supply chain procurement** or **logistics**.) As a result, the manufacturer enters into a series of contracts to enable it to produce the goods. These are known as **upstream contracts** (the manufacturer's money is flowing up the supply chain).
2. Next, it has to get the product to the ultimate consumer as cheaply and efficiently as possible. This process is known as **supply chain management**. Here the manufacturer organises a series of contracts to enable it to sell the goods. These are known as **downstream contracts** (the manufacturer passes the products down the supply chain, thus generating income for the business).

We have used a relatively simple supply chain example, where raw materials are being manufactured into a single product, but the logistics can be much more complicated, such as car manufacture. Cars are manufactured from a variety of component parts, such as doors, mirrors, windscreens, engine parts, electrics, nuts, bolts, and so forth. Possibly over 70% of the components will be manufactured by someone else and bought in, often from different countries. A supply chain of this sort can be immensely complex, a 'logistical nightmare' in the true sense.

13.4.5 **Consumers**

At the other end of the supply chain are the consumers.

> **Essential explanation**
>
> **Consumers** are the end users of goods or services. They buy products for their own use, and not to use them in manufacture or to sell them on to other buyers.

They too want to buy the goods as cheaply as possible. Understanding the consumer market is vital for any business wishing to exploit its products successfully.

We live in a consumer society where the economy is highly dependent on consumer spending, and consumers are encouraged to buy material goods. The 1980s saw the rise of consumerism and a change in the way that people shopped. Rather than just buying necessities, people wanted luxury goods, for example designer clothes, mobile phones, computers, electrical goods, or luxury cars. The Office for National Statistics' report on household spending in 2012 shows that the percentage that consumers spend on **consumer durables** continues to rise despite the recession.[30]

> **Essential explanation**
>
> **Consumer durables** are cars or vans, central heating, washing machines, tumble dryers, dishwashers, microwaves, telephones, mobile phones, satellite receivers, CD and DVD players, home computers and internet connection, etc.

There has been a consequential rise in the amount of money that people spend, partly as a result of the increasing availability of credit during the 1990s and the first decade of the 21st century. Spending on these items has been encouraged by advertising (and again, consequentially, increased the importance of mass and social media). There is much more emphasis on 'quick fix shopping' and shopping as a leisure activity. This, in turn, has led to a change in the types of shops people use, away from small retailers to supermarkets and national chains located in large shopping malls. For example, part of the Olympic Park development is the Westfield Shopping Centre in Stratford. It is the largest urban shopping centre in Europe, and cost £1.45 billion to build.[31] Increasingly, during the last decade, consumers are shopping online. For example, leading up to Christmas 2011, internet sales increased by 25% on 2009, totalling £6.8 billion.[32]

30 ONS, *Family Spending 2012 Edition Release*, http://www.ons.gov.uk/.
31 Rebecca Smithers, 'Inside Westfield Stratford City', *The Guardian*, 21 May 2011.
32 Graeme Wearden, 'Online shopping hit an all time record in December', *The Guardian*, 21 January 2011.

13.4.6 Consumer protection

Despite their immense power as a group, individual consumers can be vulnerable, particularly at the hands of large producers. The rise of the consumer market has been accompanied by increasing regulation to protect consumers from unscrupulous suppliers. Consumer protection is a vast and specialist area of law, and it is very difficult to summarise. A good starting point is the website of the Office of Fair Trading, which tells you the bare minimum that a consumer who buys goods or services can expect.[33]

Chapter 7 looks at the Sale of Goods Act 1979 and the Unfair Contract Terms Act 1977, two of the main consumer protection measures. At the very least, goods must be of **satisfactory quality** (not faulty), be **fit for purpose** (do what the buyer expects them to do), and **match any description** that has been given (e.g. by a retailer, on the packet, in a brochure, or on a website).[34] If not, consumers can return the goods, claim a refund, or ask for a repair. Consumers who buy a service, like gym membership or hairdressing, can expect that the service will be carried out with **reasonable care and skill** (properly) within a **reasonable time** and at a **reasonable price**.[35] If not, consumers can get their money back. These are all statutory protections over and above any guarantee that a supplier or retailer provides to the customer.

In the early days, as more regulation was introduced, producers and retailers began to include clauses in contracts to protect themselves against liability (known as **exclusion clauses**) stating, for example, that faulty goods could not be returned and no refunds would be given. That was soon stopped, and there is extensive legislation preventing the exclusion of consumer rights in relation to goods and services.[36]

Regulation is all very well if consumers know about it, but to be effective consumers must be aware of their rights. Here are some examples of little known, but extremely useful, consumer protection measures:

- **Online sales**: If they buy goods online or over the phone, consumers have a right to change their minds (this is called a '**cooling off period**') and can send the goods back, usually within seven days. There does not have to be a reason. This applies even if the consumer has used the goods during the cooling off period and goods are no longer in perfect condition.[37]
- **Credit card sales**: Where a consumer has bought goods or services costing between £100 and £3,000 using a credit or debit card, the card company or bank is responsible if anything goes wrong.[38] The idea is that consumers should never be left in the position where they have to pay a debt for something that never arrives or cannot be used. This is a particularly useful provision if the company which has provided goods or services goes bust. Generally, where possible if you are buying anything that costs more than £100 it is much better to use your credit card, as you get double protection. This is illustrated by Example 7.

[33] http://www.oft.gov.uk/. [34] E.g. Sale of Goods Act 1979.
[35] E.g. Supply of Goods and Services Act 1983.
[36] E.g. Unfair Contracts Terms Act 1977 and Unfair Terms in Consumer Contract Regulations 1999 (SI 1999/2083).
[37] Consumer Protection (Distance Selling) Regulations 2000 (SI 2000/2334).
[38] Consumer Credit Act 1977.

Example 7

You buy two pairs of shoes costing £150 each online using a credit card. You wear the first pair for one day at work, but they are uncomfortable. You wear the second pair for a week and the heel falls off. What are your legal options?

- **Pair 1**: Provided that you send the shoes back within the seven-day cooling off period, you can get your money back. It does not matter that you have worn them. In legal terms, all you need to do is to take 'reasonable' care of them during that time.
- **Pair 2:** Clearly these shoes are defective. In legal terms they are neither of satisfactory quality nor fit for their purpose. You have a statutory right to a replacement, repair, or refund. If you decide that you want your money back, because you paid with a credit card, you can choose whether to claim your money back from the seller or the credit card company.

13.4.7 **Competition**

Where two or more businesses operate within a particular market or sector providing the same goods or services, they will be competitors. If we return to the example of the typical high street in 13.2, there are several obvious competitors and some non-competitors within that geographical market.

For example, high-street competitors might include the following examples:

- Costa and Starbucks both sell coffee;
- Waitrose and M&S Simply Food are upmarket supermarkets selling food;
- Next, New Look, and the boutique sell ladies' clothes;
- Lloyds TSB and Santander provide banking and financial services.

These are competitors because they are operating in the same sector selling similar products.

Non-competitors on the high street might include:

- the gift shop, phone store, and hardware store—if there are no others in the high street, they have no competition;
- solicitors, accountants, and estate agents are all operating within the service sector, but the services which they provide are complementary rather than competitive (if someone wants to buy a house, the estate agent may recommend the solicitors to do the property work and the solicitors may recommend the accountants to give any financial advice which their clients may need).

The high street illustrates how competition works, but it is only a very small local market. If we expand the geographical area, the amount of competitors will increase. For example, many towns have out-of-town shopping centres, where you will find large supermarkets, such as Tesco or Asda, which would clearly provide further competition for the food stores in the high street. There are likely to be other mobile phone providers. Large supermarkets will sell gifts, so the gift shop will face competition here. There may be a McDonald's or KFC which will increase the choice for fast food. At the other extreme, the two banks operate within a global market, competing for customers throughout the world.

The level of competition is determined by the number and size of the businesses operating in a particular market.

Essential explanation

A **monopoly** is where one business dominates the market, such as Microsoft within the global market for computer operating systems.

An **oligopoly** is where a few businesses dominate the market, for example Tesco, Sainsburys, Asda, and Morrisons together have a 75.4% share of the UK grocery market.

A **competitive market** exists where there are hundreds or thousands of producers, none of which are particularly large or dominant. If you look, for example, in the Yellow Pages for any local area, you will see that there are hundreds of small businesses, such as hairdressers, pubs, or plumbing services, all competing within the same market.

A **cartel** is where two or more businesses join forces to dominate a particular market. An international example is OPEC (Organisation of Petroleum Exporting Countries) which dominates the world oil market.

The structure of the market and the market conditions will affect prices. If a business has a monopoly, or is operating as part of a cartel, it will be able to charge more than a business which is operating in a competitive market. This is clearly not a good thing for consumers.

In the same way that regulation exists to protect consumers from unscrupulous suppliers, there is considerable regulation to protect against anti-competitive practices. Competition law (which you may see referred to as **anti-trust** internationally) is designed to promote healthy competition. Understanding this area of law is vital for any business as breaking the law can have very serious financial consequences. Since 1990, Microsoft has been fined €1.64 billion for anti-competitive behaviour.[39] In 2009, Intel was fined $1.45 billion (£948 million) for trying to bully and bribe its customers into only buying its chips to keep its nearest competitor out of the market. It was said to have 'resorted to old-fashioned threats, intimidation and kneecapping' as well as paying ('bribing') manufacturers to use their chips rather than any others.[40]

13.4.8 **Environment**

The environment in which a business operates, its markets, its customers, and the competition it faces will influence all of the decisions which the managers of the business make. These factors are also important considerations for lawyers when advising any business. The emphasis throughout this chapter has been on the economic and financial environments, so those are what we will explore in Chapter 14.

Summary

- Firms expect their lawyers to be commercially aware. In practice, commercial awareness is about understanding personal, financial, and business concerns of clients and the environment in which those clients operate. For students, developing understanding of these issues will help with your studies and employability skills.

[39] Charles Arthur et al., 'Microsoft loses EU antitrust fine appeal', *The Guardian*, 27 June 2012.
[40] Rupert Neate, 'Intel faces biggest ever EU competition fine', *Daily Telegraph*, 30 May 2009.

- In order to give effective advice to business clients you need an understanding of the main business structures—sole traders, partnerships, the different types of company—and the advantages and disadvantages of each. This involves understanding how those businesses are run and managed, and by whom and investigating a business's strategy and objectives.
- Finally, it is crucial to understand the environment within which a client is operating and take into account the factors that contribute to that environment: political, economic, social, technical, and legal. Businesses operate within a variety of sectors and markets; you need to be able to understand the market in which that client operates, how the client operates within the market, and the competition within that market.

Thought-provoking questions

1. What are the main reasons why someone would choose to set up in business as a sole trader rather than a limited company?
2. What is an LLP? What are the advantages and disadvantages of these?
3. Research a company of your choice online. What are its vision, mission, and values?
4. What do you think are the main advantages of social media sites for businesses?
5. Research a law firm of your choice online. Use the SWOT analysis to identify one strength, weakness, opportunity, and threat for that firm's business.

Further reading

Lucy Jones, *Introduction to Business Law* (Oxford: OUP 2011)
—contains an accessible introduction to the structure and management of businesses.

Christopher Stokes, *All You Need to Know about Commercial Awareness* (London: Longtail Publishing Ltd)
—essential reading for information on how companies are run and managed. Aimed more at business people than lawyers, it still provides a unique insight into the subject. A revised version is published each year.

For the authors' reflections on the thought-provoking questions, additional self-test questions, podcasts offering a variety of perspectives on legal systems and skills, and a library of links to useful websites, visit the free Online Resource Centre *at* **http://www.oxfordtextbooks.co.uk/orc/slorach/**.