5.4 Sole traders

5.4a What is a sole trader?

If you were to set up a newsagency business on your own as described in Activity 2 of section ‘5-2 Key Themes and Concepts’, you would be a sole trader. Often this is described as being ‘self-employed’. You would be the ‘owner’ of the business. Whilst other people might be involved in your business (for example, as employees or suppliers), it would nevertheless be your business.

But it follows from what we saw in Activity 2 of section ‘5-2 Key Themes and Concepts’ that being the ‘owner’ of the business involves you in a lot more than owning things. You would be the person who has all of those relevant legal relationships, rights, obligations, statuses, permissions, etc. Some of those are to do with owning things. Many are not. You are owner, buyer, seller, employer, debtor (i.e. you owe someone money), creditor (i.e. someone owes you money), contractor, tenant, taxpayer, licence holder, and perhaps a host of other things too.

5.3b Key characteristics of being a sole trader

In general terms, some of the key characteristics of being a sole trader are that:

- you ‘own’ the business; strictly, you own the property of the business, and have a variety of other legal capacities. In a more general sense, we can say that the wealth represented by the business is yours; in other words, you are entitled to all the capital of the business.
- you make the decisions which affect the nature and running of the business.
- you are entitled to the profits which the business generates.
- you are legally responsible for all of the debts and obligations of the business without limit.

In the next activity, we will consider some of the advantages and disadvantages of being a sole trader.

Activity 1: Advantages and disadvantages of being a sole trader

0 hours 10 minutes

Consider the ‘key characteristics’ of being a sole trader above. To what advantages and disadvantages do they give rise?

Discussion

The fact that you are entitled to all of the profits from the business (as well as its capital) is the attractive side of being a sole trader. If you run a newsagency as a sole trader, the profits belong to you, because the sales which generated them were sales to your customers. Whilst your customers may have conceived of themselves as buying their sweets and magazines from 'the newsagents', in the eyes of the law, the seller is not 'the shop', but you. Customers bought their sweets and magazines from you.

On the other hand, you are legally responsible for all of the debts and obligations of the business. Suppliers and others may conceive of themselves as dealing with 'the business'. However, as we have seen, there is no single 'thing' which is the business. In the eyes of the law, they are not dealing with a 'business' at all: they are dealing with you. You are responsible for paying for the sweets and magazines supplied to you, for the gas, for the business rates, etc. If you have not paid for it, you are their debtor, and they are your creditor.

End of discussion

It may be that your business is lawfully run, makes a profit, your customers are happy, and your landlord, suppliers, employees and HM Revenue and Customs all get paid. However, if your business is not successful and 'runs out of money', then the law has much to say about who loses out.

We will examine a simple example, still in the context of a sole trader, in the next activity, where you will be able to consider a basic example of what might happen if a business run by a sole trader should fail.

Activity 2: Liability of a sole trader

0 hours 20 minutes

Imagine you had set up your newsagency investing, say, £10,000 capital into the business at the beginning. You had then run it for a number of years but it had never been a roaring success. At the end of five years, you still rent your shop. You own the fixtures and fittings, worth £5,000, and stocks of sweets and other items, worth £1,000. You also own a delivery van, worth £2,000.

Your only other wealth lies in the small flat you live in on your own. This is worth £50,000. But it is mortgaged to the building society, and you still owe them £40,000.

Now the business has hit hard times. The rent on your shop has gone up and you owe your landlord £10,000 in rent. The price of goods has gone up, and you have suppliers who are owed £7,000. They have refused to supply you with any more goods until your bill is cleared. You have outstanding bills for gas and electricity which total £8,000, and the supply of gas is about to be cut off. Your bank overdraft stands at £15,000, and the bank has refused to extend it. You have just received a tax bill for £10,000 from HM Revenue and Customs. Trade has gone down, and there is no prospect of things improving: if you carry on trading, the bills will just get bigger.

Make a list of all the amounts you own (your 'assets'), and all the amounts you owe (your 'liabilities'). You might want to use the printable PDF table available for download below this document.

Now please answer the following questions:

1. If all of your assets were sold off, would you be able to pay all of your creditors (i.e. meet all of your liabilities)?
2. What do you think your creditors will do? Do you think your home is safe?

Discussion

Here is a list of your assets and your liabilities:

Assets		**Liabilities**	
Fixtures and fittings	5,000	Bank overdraft	15,000
Stocks	1,000	Suppliers	7,000
Van	2,000	Gas and electricity	8,000
Flat	50,000	HMRC	10,000
		Rent	10,000
		Building society	40,000
Total:	£58,000	Total:	£90,000

As you can see, your liabilities exceed your assets by £32,000! If all of your assets were sold off, there would not be sufficient to meet all of your liablities.

What will your creditors do? If you do not keep up your mortgage payments, your flat may be repossessed by the building society. In any event, your other creditors will probably sue you, and if you cannot repay them, you may find that eventually they make you bankrupt (in other words, you will be found by the law to be unable to pay your debts, and as a result, your assets will be sold off and distributed amongst the persons to whom you owe money). If the building society has not already repossessed it, your flat may be sold off as part of your bankruptcy.

End of discussion

Perhaps this seems harsh that you should lose the roof over your head just because of your business failure. But on the other hand, your creditors are entitled to be paid, and in the circumstances described above, even if they have your flat sold, they *still* would not get everything to which they are entitled. After all, your liability to your creditors exceeds the value of your assets by some £32,000. This could, of course, have a very bad effect on some of your creditors too. For if you are not able to meet their bills, they may be unable to pay their own bills, and then they may struggle financially too.

A sole trader may be made bankrupt on account of their business debts. But if that happens, it is not only their *business* assets which are ‘up for grabs’: all of their assets – including all of their *personal* wealth (with some minor exceptions) – will be realised to meet the claims of their creditors. Creditors may go unpaid in whole or in part, but, in general, they will not lose *anything* until the sole trader has lost *everything*! Being a sole trader can carry a considerable amount of risk if things go wrong; for a sole trader stands to lose much more than just the *capital* which they invested in the business. Such is the potential price of being one's own boss.

Are things any better if you run a business with somebody else? Is a problem shared a problem halved, or not? We will consider this in the next section when we look at running a business in partnership.