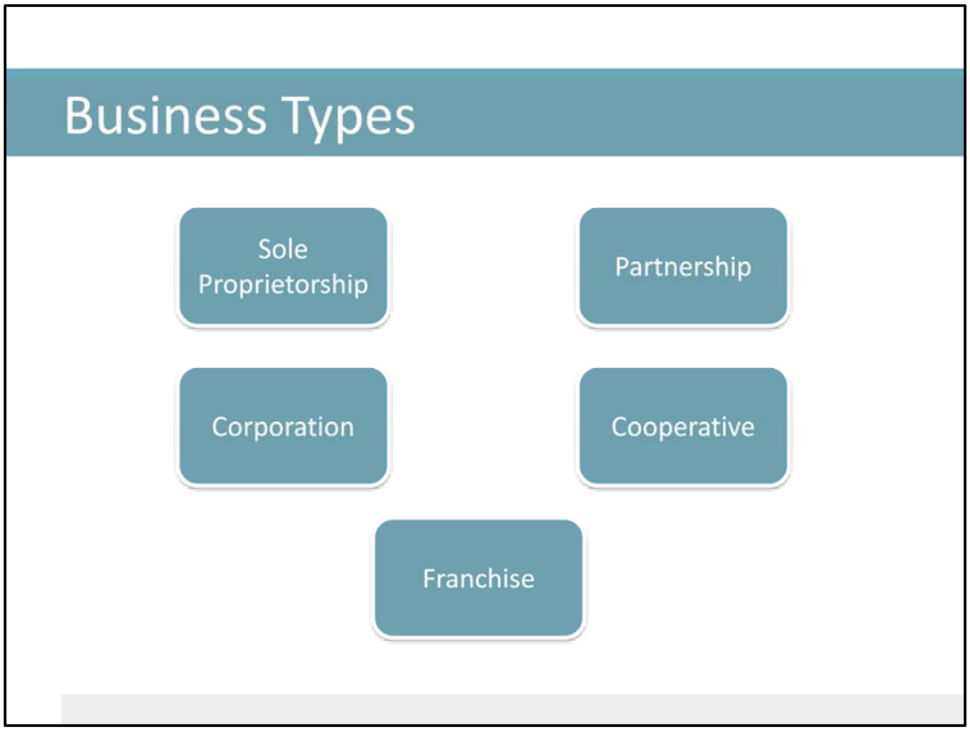
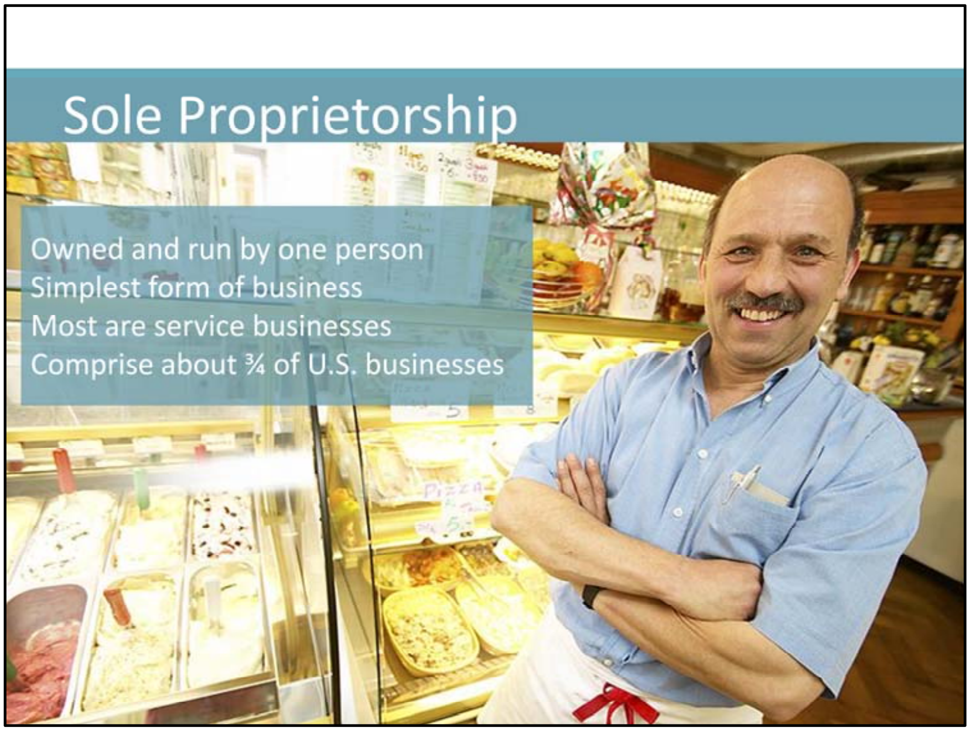
Have you ever thought about starting your own business? Maybe you and your friend have a great idea that you think people would be interested in. How would you organize the business? Who would own it? How would you pay taxes? How would you protect the company from lawsuits?

While having a great idea can help start a business, it takes a lot of planning and knowledge to keep the business successful over the long term. Entrepreneurs put a lot of time and energy into the ideas or products that make their business, but if they don't plan the rest of the business, it probably won't be successful.

Let's go over the different ways that you can structure a company, and see what the advantages and disadvantages are of each. First, imagine you're starting a company that you know is going to be successful. As you look at each type of business organization, think about how well it would work for your company and your needs.



Here are the different ways you can structure your business. Let's look at each one to see its advantages and disadvantages.



A sole proprietorship is a business that is owned and run by one person. It is the simplest form of business organization. Sole proprietorships make up most of the businesses in the U.S., but only generate a small amount of all of the sales because they are usually small businesses. Some examples are plumbers, farmers, hair stylists, truckers, writers and lawyers.

A sole proprietorship is the simplest form of business to start. There is very little red tape and little legal expense involved. You have to get a license to operate and a permit so you can collect state or local sales taxes from your customers. There are also few government regulations other than maintaining accurate tax records and following employment laws, if you have employees.

The owner has complete control and makes all the decisions about running the business including what to produce, how to produce, and how much to produce. The owner also gets to keep all of the profits. Sole proprietorships pay lower taxes than other businesses because the profit is taxed as the owner's personal income; the business itself does not pay a separate tax. Probably one of the biggest advantages of starting a sole proprietorship is the pride of ownership. As the business grows and becomes profitable, the owner gets to take credit for its success. It can be very rewarding to see a lot of hard work pay off!

Before starting a sole proprietorship, there are several disadvantages to consider. Unlimited personal liability is probably the biggest. This means that the owner is responsible for any losses the company may have, and has a legal obligation to pay any business debts. An owner may have to use their personal savings or sell personal assets (like a home or a car) to pay business debts.

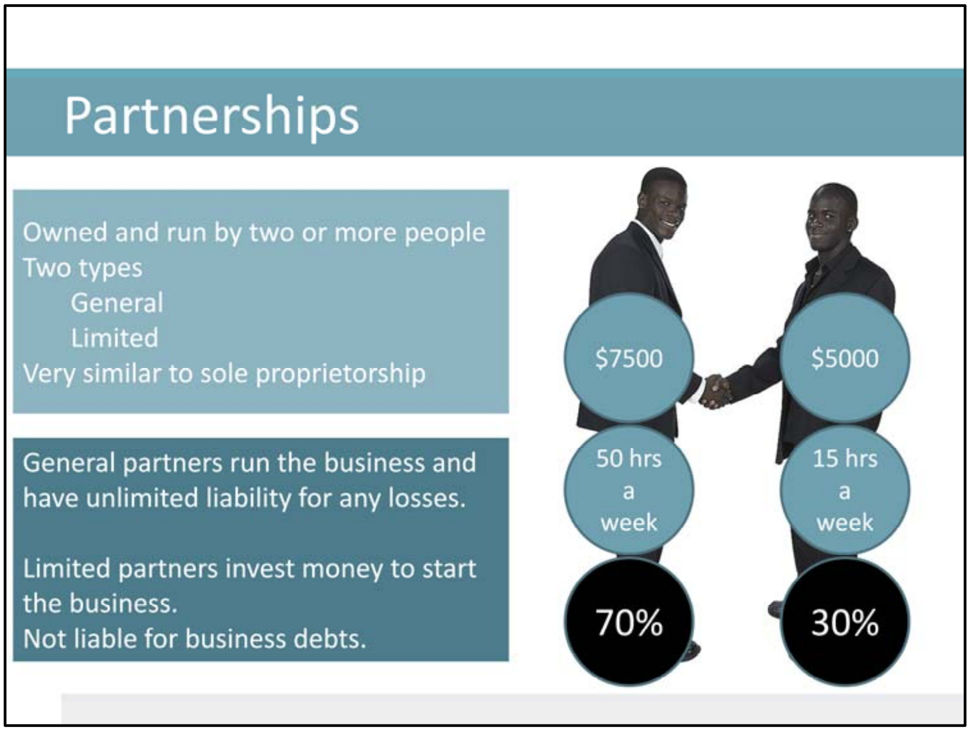
It's difficult for these businesses to raise capital funding, which is money to start the business. Banks are wary about lending money to a new business with no track record and few assets. They will look at the potential owner's personal assets when deciding if they will lend money to the business.

A third disadvantage is limited life. The owner is the life of a sole proprietorship. It is founded on his or her talents, efforts, and investment. So, if the owner dies or quits, the business ends. If the business is sold to a new owner, a new business has to be created.

It is difficult to find and keep good workers. There is little job security and little (if any) opportunity for advancement in a small business, so it may be difficult to find more than temporary employees.

Finally, running a sole proprietorship is a huge responsibility for the owner. He or she must manage the business, keep the financial records, supervise production and employees, conduct marketing activities, compete with other businesses, and much more. Sole proprietors often can't afford to hire others to do these things, so they end up working long hours and have lots of stress. They may not have the ability or talent to do all of these things well.

Suppose you are a hair stylist who owns a salon. Not only will you have to cut and style hair, but you will also have to clean the salon, deal with upset customers, handle employee disputes, count all the money, make daily deposits, do payroll for your employees, keep tax records, and much more. Suppose that you are not good at confrontations, you will have trouble disciplining employees and dealing with unhappy customers, but you will still have to do those things in your daily operations, and you will have to do them well if your business is to be successful.



In a partnership, two or more people decide to open and run a business together. They agree to pool their talents and resources in exchange for a share of the profits and losses of the business.

There are two basic types of partnerships. The first is the general partnership, which is the most common. Partners share the responsibility in running the business, and they share the profits and debts incurred while operating the business. Keep in mind that profits and losses may not be shared equally. The partners may decide, based on the initial investment or the amount of time invested in running the business, to give one partner a higher percentage of the profits and losses.

For example, suppose you and your best friend decide to start a restaurant together. Imagine that you invest seven thousand five hundred dollars and your friend invests five thousand dollars. Suppose also that you are going to work in the restaurant Monday through Friday ten hours a day, and your partner will work ten hours on Saturdays and five hours on Sundays. Because you are investing more money and working longer hours, you and your partner may decide that you deserve more of the profits and losses of the business. In this case, when setting up the business, you create a partnership agreement stating that profits and losses will be divided at a rate of seventy percent for you and thirty percent for your friend instead sharing equally.

The second type of partnership is a limited partnership. In this type of organization, there are two types of partners—general and limited. General partners are responsible for running the business and have unlimited liability for any losses incurred. Every limited partnership must have at least one general partner. Limited partners don't manage the business; they invest money to start the business. They are called limited partners because they can only lose what they invested in the business; they are not liable for any debts that the business incurs. A limited partnership can have as many limited partners as desired.

Partnership Advantages

- Easy to start
- Few government regulations
- Shared decision making and increased specialization
- Greater ability to raise financial capital
- Better able to attract and retain workers
- Lower taxes

Like sole proprietorships, partnerships are easy to start. There is very little red tape and little legal expense involved. You have to get a license to operate and a permit so you can collect required state or local sales taxes. The partners need to agree on how to share the business responsibilities, profits, and losses. This is usually done in a written agreement called a partnership agreement or articles of partnership. It is usually best to have an attorney draw up the partnership agreement and have all partners sign.

Like the sole proprietorship, there are few government regulations other than maintaining accurate tax records and following employment laws, if there are any employees. General partners usually make operating decisions together, which may lead to better decisions because of the multiple points of view. In addition, each partner has different abilities and skills so the partnership can be run more efficiently. For example, one partner may be good at bookkeeping and another may have excellent people skills. This allows the partners to specialize in what they do best, which benefits the overall efficiency of the business.

It's often easier for partnerships to get loans from banks than sole proprietorships. Banks are more willing to lend to partnerships because there are more people investing in the business and more people to guarantee the debt with their own personal assets. Any bank loans would be backed by all general partners' promises and property.

Partnerships may also be better able to attract and keep their workers because there is more opportunity for advancement than with a sole proprietorship. Loyal, hard working employees may have the opportunity to become partners in the business. Like the sole proprietorship, a partnership does not pay a separate income tax. The income of the business is taxed through the partners' personal income tax.

Like sole proprietorships, general partners have unlimited liability for the company's debts and must pay them even if it means using their personal savings or having to sell personal assets (like a home or car). This is true even if only one of the partners made a mistake or a poor decision that caused the debt. All general partners are responsible for all activities of the business. Limited partners, on the other hand, cannot be held liable for these debts.

Another disadvantage is that the partnership is limited to the life of its owners. When one partner dies or leaves, the partnership ends. The remaining partners can form a new partnership to continue the business, but the old partnership is dissolved.

Since there are multiple partners, they may disagree about how to run the business, which can disrupt operations or even end the partnership. This is why it's important for the partnership agreement or articles of partnership to clearly state how disagreements will be handled.

Finally, profits must be shared. Again, profits do not have to be shared equally, and are shared according to the partnership agreement. However, if one partner fails to do his or her part, it can be unfair to the remaining partners when they must share the profits. This can cause problems in the business and may end the partnership.

Think of a corporation as a person. The company has the rights and responsibilities of a businessperson. A corporation, as a legal entity (or being), can earn a profit, lose money, be sued, and be found guilty of a crime.

The process of starting a corporation is more complicated than the others we have covered. When a person or group of people want to start a corporation, they must submit a written application to the state in which they wish to operate. This application is called the articles of incorporation and it basically asks permission to open and do business in that state. When the application is approved by the state, it becomes a charter, which is the legal authorization or permission to organize the corporation.

Owners of a corporation are called stockholders. The corporation issues shares of stock, which are pieces of ownership. These shares entitle stockholders to the profits of the business and voting rights on various issues, such as who will manage the daily operations of the corporation. Stockholders are also entitled to dividends, which are portions of that year's annual profits. If a corporation decides to distribute dividends, each stockholder gets a part of that profit based on the number of shares he or she owns.

There are two basic types of corporations—private and publicly traded. Private corporations are owned by a group of people, and the company stock is not traded on any stock exchange. In other words, you usually can't buy any ownership in the company shares unless the private owners allow it. Many times shares of private corporations are passed within families upon the death of the owner. Publicly traded corporations are ones that sell shares of stock (or ownership) to the public on the stock exchange. Unlike private corporations, these businesses are highly regulated by the Federal Government and have to publish reports that show their profits or losses every year. Publicly traded corporations are usually larger than private ones.

Corporations have a lot more ways to raise money than sole proprietorships and partnerships. For example, they can sell stock, issue bonds, which are similar to loans, or get loans from banks. Unlike sole proprietorships and partnerships, all corporate owners have limited liability, which means they aren’t responsible for the debts of the corporation. Even if the corporation goes bankrupt, the owners would only lose their original investment. Creditors cannot go after the owners’ personal savings or assets.

Corporations also have unlimited life. Since the corporation is considered to be its own entity, the death or departure of a stockholder does not affect the life of the company. When an owner sells his or her stock, the new owner becomes part of the corporation and the business continues unchanged. If a stockholder dies, the shares pass on to his or her heirs and the business continues.

Finally, owners of a corporation may not be involved in running the business. The corporation hires experts to run the business, which means that the management is specialized based on each job that needs to be done.

Like other types of business, the corporation has its disadvantages.

The articles of incorporation that are required to start the business are usually drawn up by an attorney who specializes in that type of business, which can be expensive. These documents can be complicated to create, and it may be difficult to get governmental approval as well.

Corporations are highly regulated by the Federal Government. There is a lot more red tape involved in starting and running a corporation, especially publicly-traded ones. Publicly-traded corporations must issue financial reports quarterly (every three months) and create annual reports using an independent accounting firm. These reports are public and filed with the Securities Exchange Commission.

Owners have less control in a corporation. Professional managers take care of the day-to-day business operations. Their expertise is usually good for the corporation, but they make their decisions in the best interest of the corporation, which may or may not be in the best interests of the individual stockholders.

Finally, it can be argued that the owners are taxed twice. Since the corporation is a separate entity, it must pay taxes on any income it earns. When the company distributes its profits to the stockholders through dividends, the stockholders pay personal income tax on that money as well.

Cooperative are basically groups of people who decide to pool their resources to buy and sell more efficiently than they could independently. Most cooperatives are tax exempt.

There are three types of cooperatives—consumer, service, and producer.

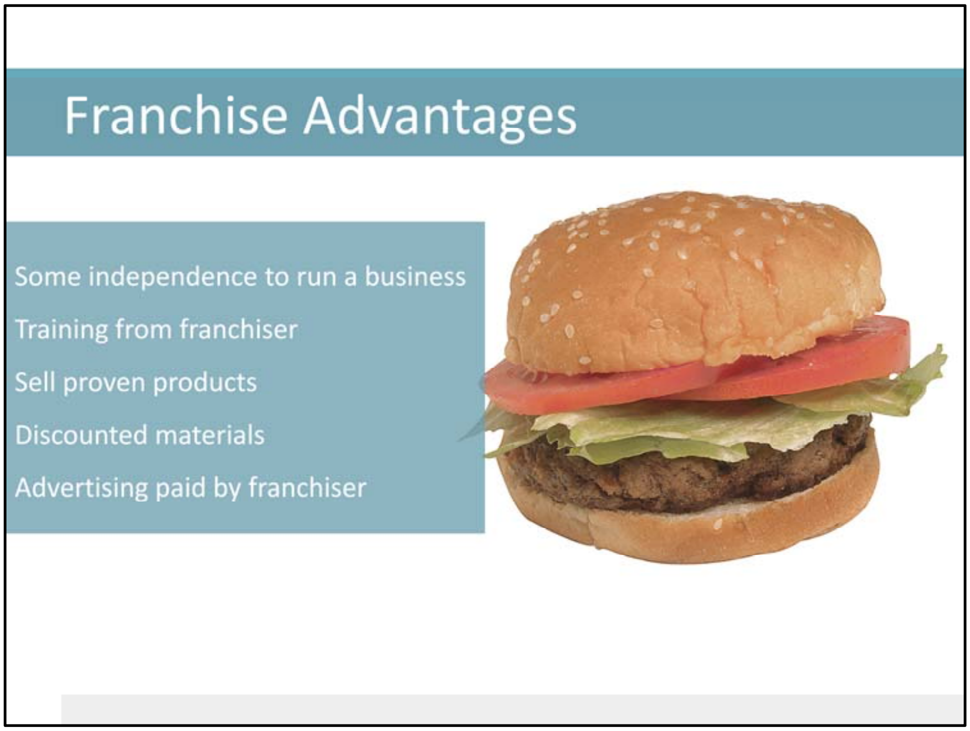
A consumer cooperative is a retail business owned and operated by some or all of its customers so they can reduce costs. Consumers in the cooperative may have to pay a yearly fee or be required to work for the cooperative a certain number of hours each year. Members may get discounts on merchandise or may share in the profits. Some grocery stores and college bookstores may be organized as consumer cooperatives.

Service cooperatives offer its members a service instead of a product. Credit unions and electric-power facilities are examples of service cooperatives. Sometimes a company will form a service cooperative to reduce the cost of buying health insurance for its employees.

Producer cooperatives are formed when producers join together to buy supplies and equipment in order to market their output and to reduce costs and increase profits. The most common type of producer cooperative is a farm cooperative where farmers pool funds to purchase machinery and supplies. They may also provide storage, processing, and transportation to market, which eliminates wholesalers and maximizes profits. The Federal Government does not view this type of cooperation among farmers as a violation of antitrust laws. Firms in other industries would not be allowed to do this legally.

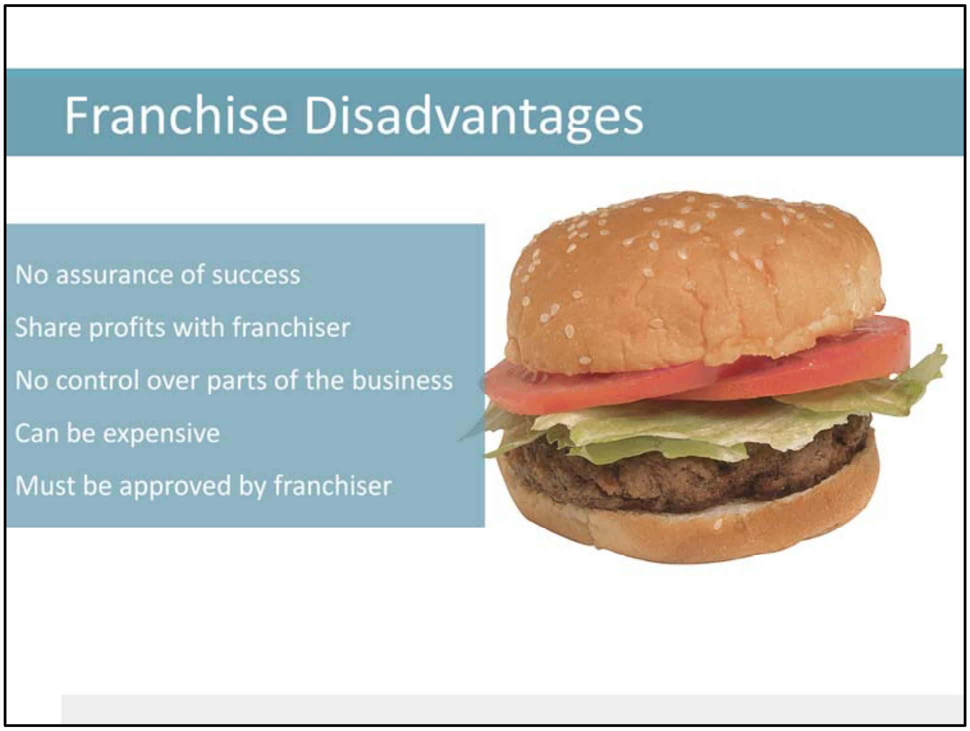
A franchise gives owners the right to sell the products that are produced by a parent company in a particular area. Although each franchise is independently owned and operated, they have to follow certain procedures and rules that are established by the parent company.

The franchisee is the individual business and the franchiser is the parent company. The franchisee pays a fee to the franchiser for the right to sell the company's products and services. The most common franchises are fast food restaurants like McDonald's. Other examples are hotels, rental car companies, and restaurants.

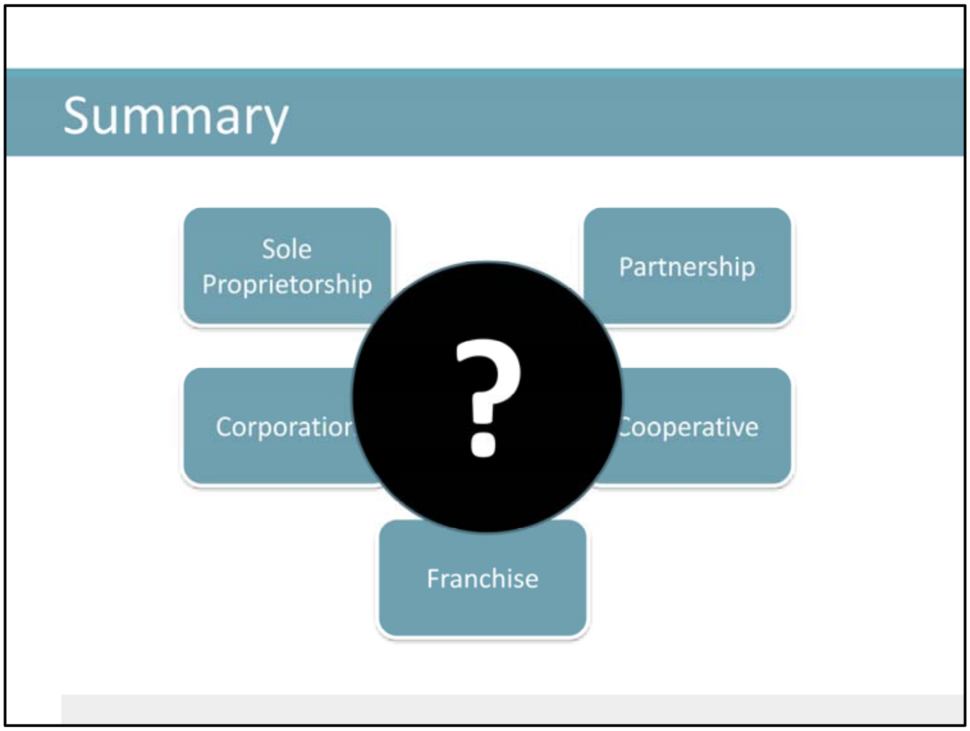


The franchisee is independent and has the pride of running his or her own business. They also get management training from the franchiser. Since the owner buys the right to use the name and products of the parent company, they are starting off with a proven track record. For instance, when you go to McDonald's to get a Big Mac, you get the same product regardless of which McDonald's you go to. All McDonald's restaurants use the same recipes, preparation techniques and ingredients as set up by the parent company, although other items on the menu may vary depending on the state or country.

Have you ever noticed that every McDonald's restaurant is decorated very similarly? The parent company dictates some of the guidelines for how to decorate, but they also offer the materials for the décor at reduced prices to franchisees. In addition, the franchiser pays for national or regional advertising, which saves each owner a lot of money!

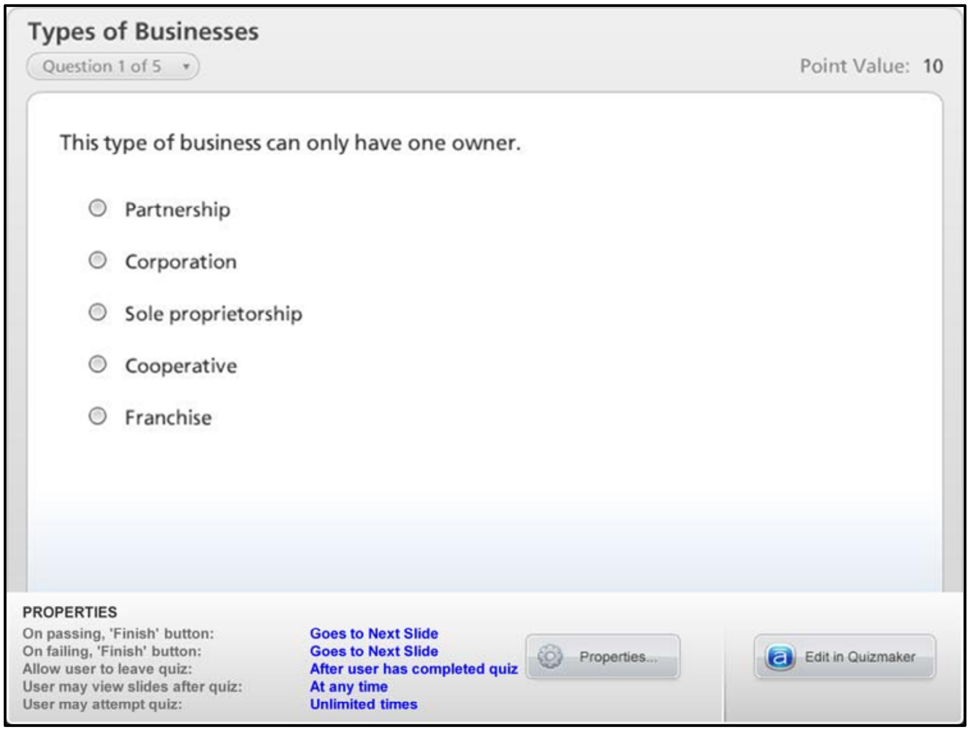


There are some disadvantages of being a franchisee. To open a franchise, a person must pay a fee to the parent company. This investment is required regardless of whether or not the business is successful. Franchisees are also required to pay a certain percentage of profits to the franchiser every year. Although the franchisee is an individual business owner, he or she must still follow the policies and rules of the franchiser. They also must buy only from the franchiser, which limits the products that can be offered at the franchise. The franchise fee can be expensive, especially for well-known franchises, and the franchisee must be approved in order to open a franchise.



As you can see, there are many different ways to organize a business to fit the needs of anyone starting out, or reorganizing as their business grows.

This topic started out asking you to think about a business you might start. How would you organize it at first? Do you think you might need to change it if became very successful?


Types of Businesses
Question 1 of 5
Point Value: 10
This type of business can only have one owner.
Partnership
Corporation
Sole proprietorship
Cooperative
Franchise
PROPERTIES
On passing, 'Finish' button: Goes to Next Slide
On failing, 'Finish' button: Goes to Next Slide
Allow user to leave quiz: After user has completed quiz
User may view slides after quiz: At any time
User may attempt quiz: Unlimited times
Properties...
Edit in Quizmaker