Corporate Issuers

Organizational Forms, Corporate Issuer Features, and Ownership

Exam Focus

- Business structures
    - Identify and compare features of the 4 key structures
- Key features of corporations
    - Identify important corporate features, including key differences between private and public corporations

Business Structures

Sole proprietorship: owned and operated by an individual, taxed as personal income; owner has unlimited liability (e.g., a family-owned business)

Partnership: a business owned by multiple owners

- General partnership: Two or more individuals (general partners) own and operate the business and are liable for claims. Income is taxed as personal income.
- Limited partnership: General partners (GPs) manage the business and are personally liable for claims against the business. Limited partners (LPs) are only liable for the invested amount. All partners receive a share of profits and losses (GPs: usually higher share).
    - Limited liability partnership (LLP) is a special case composed entirely of LPs.

Business Structures

Limited companies: benefits are greater access to financing and potential for growth

- Private limited company: known as LLC in the U.S.; all owners have limited liability, with company usually professionally managed, and ownership is divided into private shares
- Public limited company (corporation): legal identity separate from owners, profits taxed, dividend recipients taxed; also limited owner liability, but no restriction on number of owners; most suitable for going public (IPO)
  - Key features of the corporate structure: (1) separate legal identity, (2) owner-manager separation, (3) owner-shareholder liability, (4) access to external equity or debt financing, (5) double taxation

Business Structures: Example

Comparing business structures by owner liability

When comparing a (1) general partnership, (2) private limited company, and (3) sole proprietorship by the level of owner liability of business debts:

- In both the sole proprietorship and general partnership forms of organization, the owners are personally liable for all debts assumed by the company.
- In a private limited company, owner (shareholder) liability is limited to the value of their ownership stake.

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Ownership Structures: Example

Which of the following organizational forms provides for the *least* owner liability of business debts?

A. General partnership.

B. Private limited company.

C. Sole proprietorship.

Business Structures: Example

Consider a corporation that pays a 21% tax rate on pre-tax income of USD100 million. The corporation distributes USD10 million to its shareholders. Individuals pay a 20% tax on dividend income.

- The corporation pays USD21 million in income taxes at the corporate level.
- But shareholders also pay USD2 million in individual income taxes on dividends received.
- In total, USD23 million in income taxes were paid on the pre-tax income of USD100 million. Effectively, the USD10 million paid as dividends was taxed twice, first as business income and again as personal income.

Summary of Business Structures

Feature	Sole Proprietorship	General Partnership	Limited Partnership	Corporation
Legal identity	No separate legal identity	No separate legal identity	No separate legal identity	Separate legal identity
Operator of business	Owner	GPs	GPs	Board and management
Owner liability	Unlimited (sole)	Unlimited (shared)	GPs unlimited, LPs limited	Limited
Taxation	Personal income	Personal income	Personal income	Double taxation
Access to financing	Limited	Limited	Limited	Unlimited

Key Features of Corporations

The most important features of corporations include the following:

- **Legal identity**, that is separate and distinct from its owners
- **Owner-manager separation**, between shareholders and managers/board
- **Owner/shareholder liability**, which is limited but shared
- **External financing**, with access to both debt and equity financing
- **Taxation**, with corporate profits taxed (but problem of double taxation)

Public and Private Corporations

Benefits of public listing

- Allows transfer of ownership
- Liquidity
- Regulatory transparency and disclosure
- Price transparency (allows investors to track value)

Benefits of private listing

- Controlling owners/managers are accountable to fewer shareholders
- Potential for investors to earn higher returns
- Fewer disclosure requirements

Public and Private Corporations

Going from private to public

- Initial public offering (IPO)
- Direct listing of shares (lists existing shares, no new capital, no underwriter)
- Acquisition by a public corporation
- Special purpose acquisition company (SPAC)—a company set up solely to purchase a private company which then becomes public

IPO example: In 2010, Tesla Motors (now Tesla Inc.) chose an IPO on NASDAQ.

Direct listing example: In 2018, Spotify chose a direct listing on the NYSE in order to prevent diluting its existing shares.

Public and Private Corporations

Going from public to private

- Involves investors buying all the shares of a public corporation and delisting the company
- Allows for restructuring and greater control over company
- More frequent now in developed markets
- Example is a leveraged buyout

Public and Private Corporations: Example

Public or private?

Consider a corporation that has no need for new equity financing, its debt needs are satisfied through an existing bank credit facility, and it has a majority owner which exercises management control of the company. Is this corporate issuer more likely public or private?

- The issuer is more likely private. The lack of need for new equity capital implies less reason to have exchange-listed stock.
- The business is able to operate with the current debt capacity available under its existing credit facility. The majority owner exercising management control could possibly imply either public or private, but with the first two attributes it overall implies private.

Corporate Issuers: Example

Corporate issuers are characterized by all of the following except:

A. corporate income is taxed at both the corporate and personal levels.

B. owners do not need to be involved in management of the company.

C. the owners of the corporation are not legally distinct from the corporation.

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A corporation is a legally separate entity from its owners.