Forms of Business Structure

Course Objectives

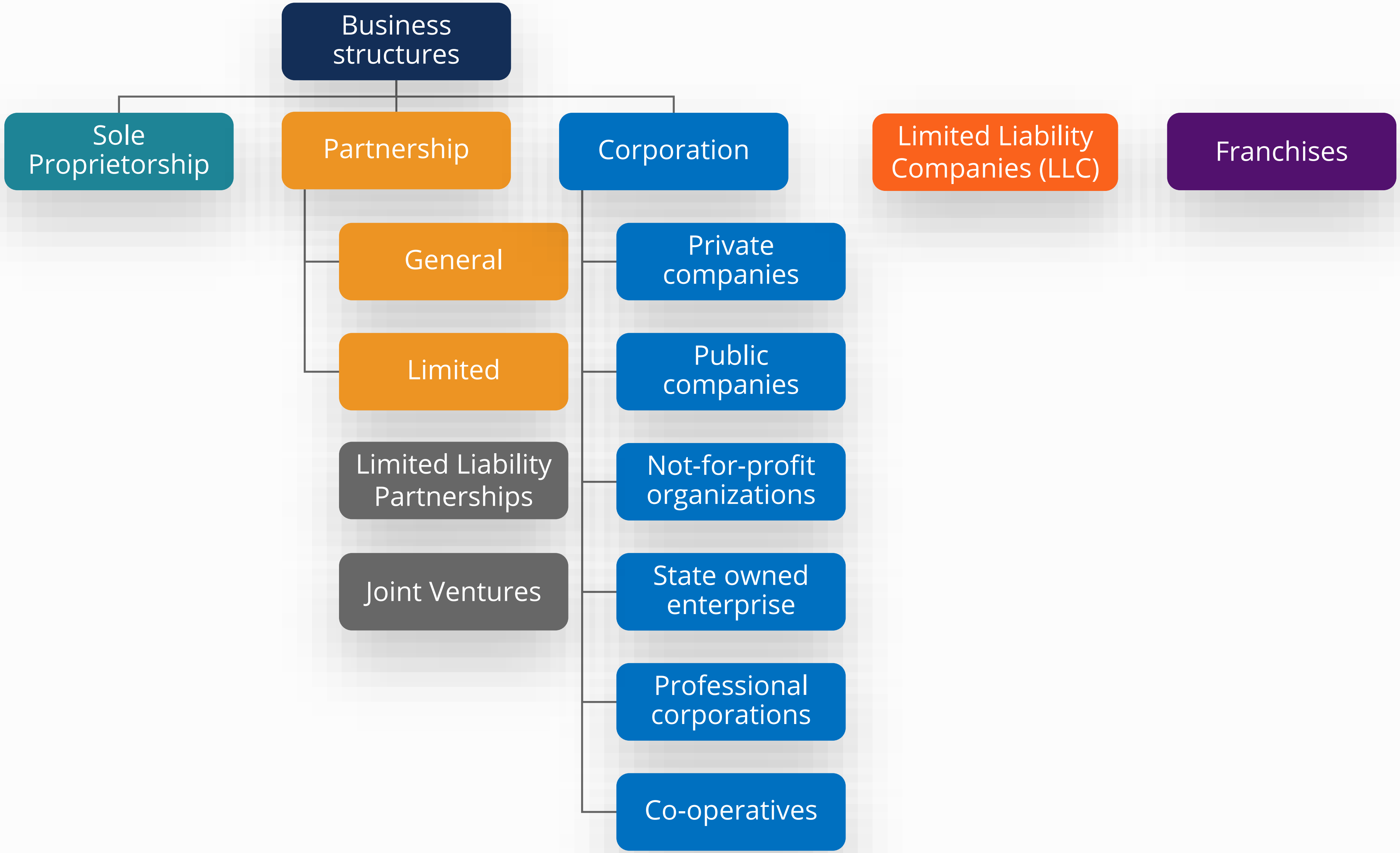
Distinguish between the three most common types of business structures

Learn the definition, advantages and disadvantages of each business structure

Understand the liability, rights, and restrictions of different structures

Understand how the legal structure of a company affects the lending process and lending decisions

Summary Chart of Business Structures



Sole Proprietorship

Sole Proprietorship

Sole Proprietorship

Advantages

- Easiest and simplest form of organization
- Free of many regulations and formalities of other types of ownership
- Owner retains 100% of after-tax profits.

Disadvantages

- Liability is unlimited (i.e. proprietor is fully personally liable for business obligations).
- Capital is limited to what the owner can provide or borrow.
- Business is tied to owner. If owner is unable to manage due to illness, business operations could be seriously disrupted.
- Owner may not have adequate knowledge or skills.

Examples of Sole Proprietorships

Sole proprietorships are formed for any type of business. The most typical businesses where sole proprietorships are used are for:

Operating a restaurant

Starting a bookkeeping business

Becoming a freelance writer

Providing housekeeping services

Providing hardware repair services

Offering private tutor lessons

Becoming a freelance graphic designer

Operating a local grocery store

And others….

Partnerships

Partnerships

Partnerships are similar to sole proprietorships, except it’s where two or more people own the business. They tend to be more complex in structure versus a sole proprietorship.

The partnership should be governed by a partnership agreement.

Partnership types:

- General
- Limited
- Limited liability
- Joint venture

1. General Partnerships (GPs)

All partners **manage the business and have unlimited** personal liability.

Advantages

- Better management through more diversified skill set
- More capital available through distributed ownership
- Better ability to get credit because more owners with personal net worth

Disadvantages

- Partners are jointly and severally liable for all debt obligations of the partnership.
- Legal action could be taken against partners personally – no separation between the business and the owners.

1. General Partnerships (GPs)

The partnership arrangement should be documented in a formal agreement, outlining the terms under which the partnership is formed and is to be operated.

Partnership agreement

- Provide for the handling of various capital interests in the event of a partner's retire or death
- Might prove to be difficult to attract additional partners if existing agreement creates barriers to the entry
- Slow decision making may result from the fact that various partners' voices have to be heard

2. Limited Partnerships (LPs)

Limited partnerships

- General partners manage the business
- Limited partners contribute capital (cash or other assets)
- Limited partners’ liability ends with their contribution
- General partners have unlimited personal liability

2. Limited Partnerships (LPs)

Advantages

- Liability is limited only to the amount of capital contributed by limited partners.
- General partners can raise cash without involving outside investors in management of business.

Disadvantages

- General partners are personally liable for business debts.
- More expensive to create than general partnerships
- Suitable mainly for companies that invest in real estate

3. Limited Liability Partnerships (LLPs)

03

Limited liability partnerships

- Extension of a general partnership
- All partners are protected from the actions of the other partners
- Partner is personally liable for damages resulting from fraudulent act
- Liability of other partners is limited to the assets of the partnership

3. Limited Liability Partnerships (LLPs)

Advantages

- All partners have limited liability
- Flow-through taxation status (i.e. income generated is treated as personal income of the partners)

Disadvantages

- Restricted to certain professions such as physicians, attorneys, doctors, financial advisors, and accountants. A business owner may not always be able to create an LLP.

4. Joint Ventures (JVs)

Joint ventures

- Pooling the resources of two or more entities (individual or corporate)
- Formed to complete one particular transaction
- Governed by a joint venture agreement
- Sharing of gross revenues rather than profit
- Liability is limited to the joint venture's portion of debt

4. Joint Ventures (JVs)

Advantages

- Allows sharing of risks with a venture partner
- Can be flexible (for example, a joint venture can have a limited life span)

Disadvantages

- It takes time and effort to build the right relationship, and partnering with another business can be challenging.

Examples of LLPs and JVs

Limited liability partnerships

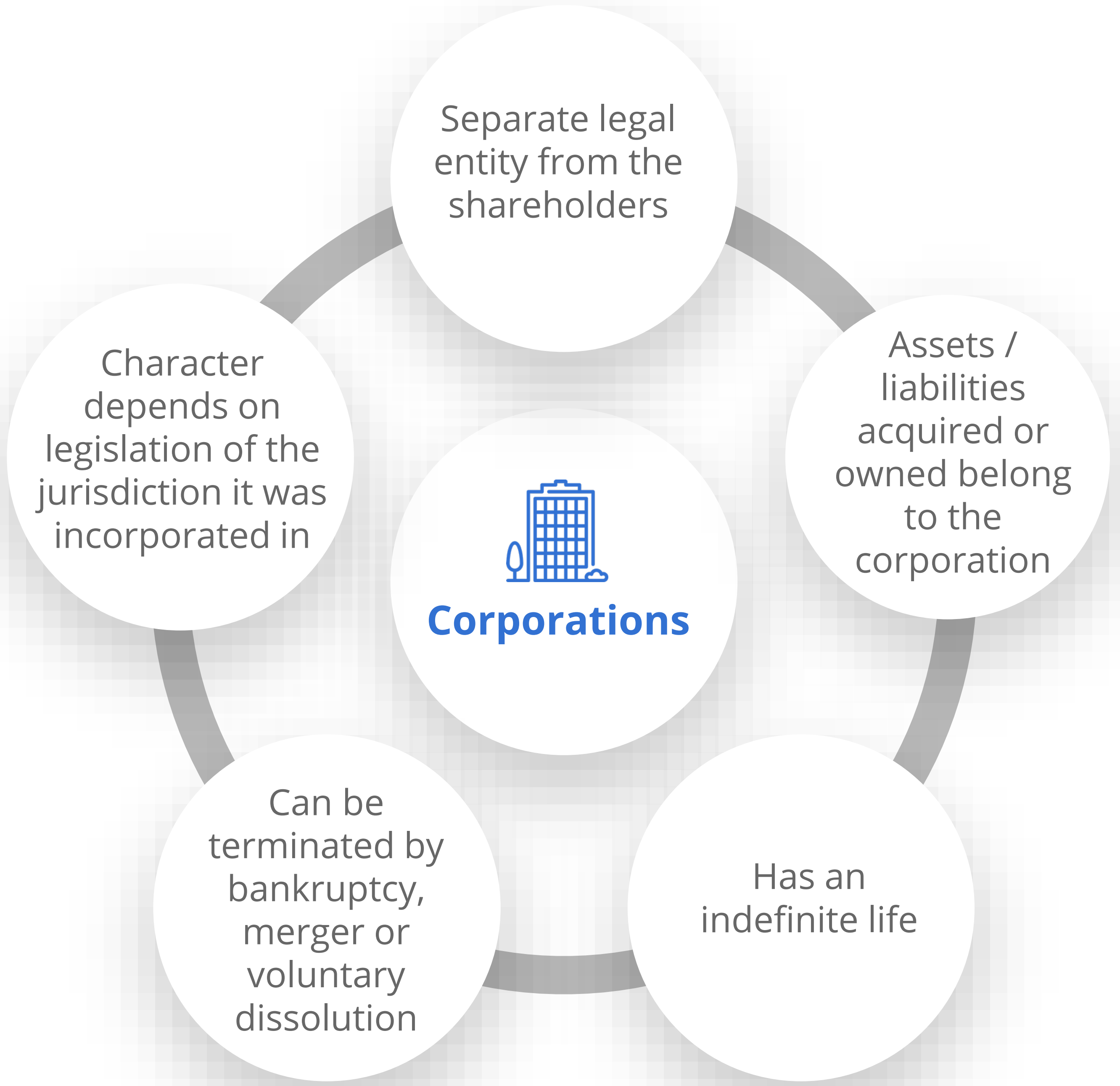
- Physicians
- Attorneys
- Accountants
- Architects
- Licensed financial advisors
- Doctors
- Veterinarians
- Undertakers

Joint ventures

- 2019 Jan – Microsoft announced joint venture agreement with Walgreens Boots Alliance to provide lower-cost health care.
- 2019 Jan – IBM and Vodafone created a joint venture to increase multi-cloud connectivity.
- 2019 May – Convergent Energy + Power and Shell Canada Energy formed a JV to install energy storage systems.

Corporations

Corporations



Corporations

Advantages

- Greater access to capital than other structures
- Liability to shareholders is restricted to investment.
- Profits are taxed in the company and often corporate tax rates are lower than personal tax rates.

Disadvantages

- Incorporation can be expensive.
- More formal regulations, including complex tax rules
- Corporation has no rights outside its articles of incorporation.

Types of Corporations

There are several different types of corporations. The most common are:

1. Private companies

2. Public companies

3. Professional corporations

1. Private Companies

Private companies

- Shares are closely held by known shareholders
- Shares are not available to general public on a stock exchange
- Restricted rights to transfer shares
- Board of directors have authority to approve or reject any proposed share transfer
- Limited number of shareholders depending on the jurisdictions

1. Private Companies

Examples:

BRIDGEWATER

MARS

DELL

McKinsey & Company

2. Public Companies

Shares may be publicly traded on a stock exchange, with no limit to the number of shareholders and no restrictions on the right to transfer.

Examples:

3. Professional Corporations

Permitted to practice in a profession such as:

Doctors

Lawyers

Architects

Engineers

Public accountants

Physicians

C Corporation vs. S Corporation – U.S. Specific

The terms **C Corp** and **S Corp** are commonly used in the U.S.

C Corporation

- Stockholders protected – limited liability
- Profits taxed within corporation as a separate entity
- Allowed to leave profits in company
- Multiple classes of stock allowed

VS

S Corporation

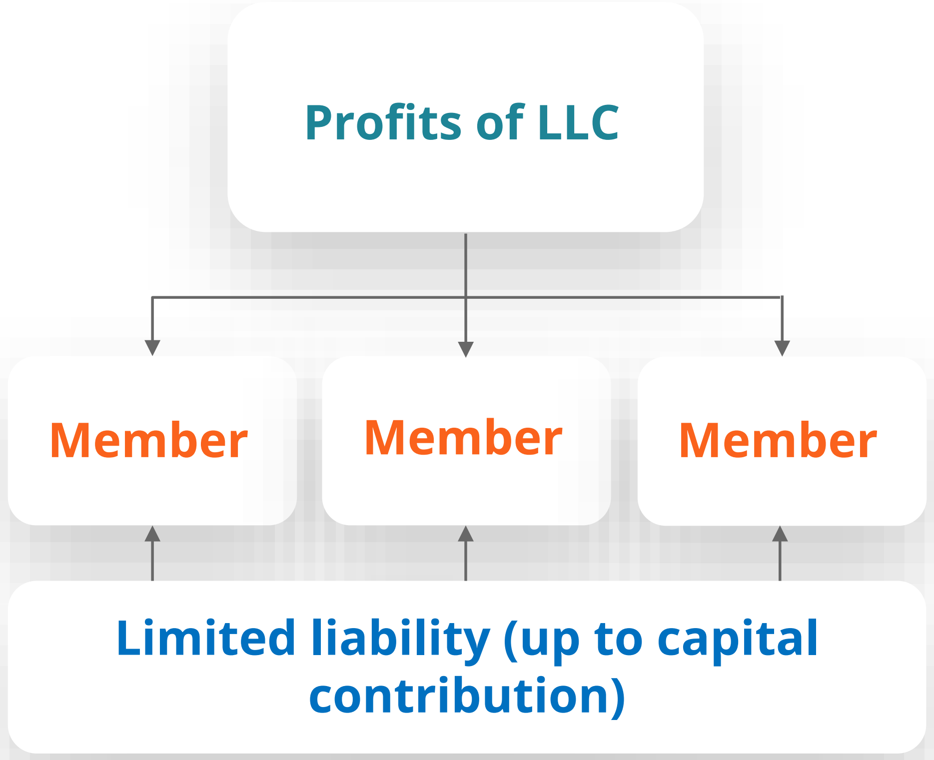
- Stockholders protected – limited liability
- Profits flow through to personal tax returns
- Only one class of stock allowed
- Allow no more than 100 stockholders

Limited Liability Companies (LLC) – U.S. Specific

LLC's are made up of members, which can be:

Individuals / **Partners** / **Corporations**

- ✔ Profit distributions flow through to, and are reported, on the members' individual returns
- ✔ Flexibility on profit distribution between members
- ✔ Limited liability for the members



Franchises

Franchises

An arrangement in which a seller (franchisor) sells a buyer (franchisee) the right to sell or distribute products/services made available through the franchisor, under the franchisor's brand.

Trademark

Marketing

Can be carried out in the form of:

Sole Proprietorship

Partnership

Corporation

Operating a Franchise

Advantages

- Proven market and established operating procedures
- Training on how to run the business is provided
- Operate under a known name or trademark
- Requires less working capital than a similar non-franchise business

Disadvantages

- Highly restrictive operating guidelines – franchisor makes all decisions
- Personal guarantees provided by the franchisee might have significant impact on credit decisions.
- Royalties, quotas and other service fees can negatively impact profitability.
- Inability to set prices may impact ability to be competitive at a local level.
- Collateral taken for security depends on the lessee of a lease agreement.

Examples of Franchises

Conclusion

Most Common Business Structures

	Sole Proprietorship	Partnership	Corporation	LLC	Franchise
Legal form	• Owner not separate from business • Profits and losses flow directly to owner • Ends on death of owner	• Made up of 2 or more people • Partnership agreement dictates how profits & losses distributed • Ends on dissolution of partnership agreement or terms within agreement	• Business is its own economic entity • Profits and losses remain in company – distribution to owners is through dividends • Indefinite life	• Made up of members, which can be sole individuals, partners, or corporations • Profit distributions flow through to the members	• Franchisee has the right to sell or distribute products/services made available through the franchisor, under the franchisor's brand.
Tax issues	• All business transactions flow through personal tax return	• Partner's share of profits and losses reported on personal tax returns • Partnership information return may be required	• All business transactions remain within company • Corporate tax return is filed	• Profit distributions are reported on the members' individual returns	• All business transactions remain within company

Why Should We Understand Business Structures?

A company's business structure can have an impact on the creditor's lending decisions and the borrower's credit application process.

Depending on the business structure, the property/assets required to secure a loan (collateral) can be different.

Why Should We Understand Business Structures?

Sole Proprietorship

If the borrower defaults, the owner's assets will be liquidated to repay as much of the loan as possible – with no separate guarantee required.

Corporation

When a business applies for loan, if the bank decides that the business does not have adequate collateral to secure the loan, they might require personal guarantee.

Credit Risk & Business Structures

The risk associated with different business structures is also a key consideration when extending credit to a company.

The size of the loan approved, interest rates and fees, terms and conditions.

Some banks or financial institutions may be reluctant to give out loans to sole proprietorships because there could be a higher default risk.

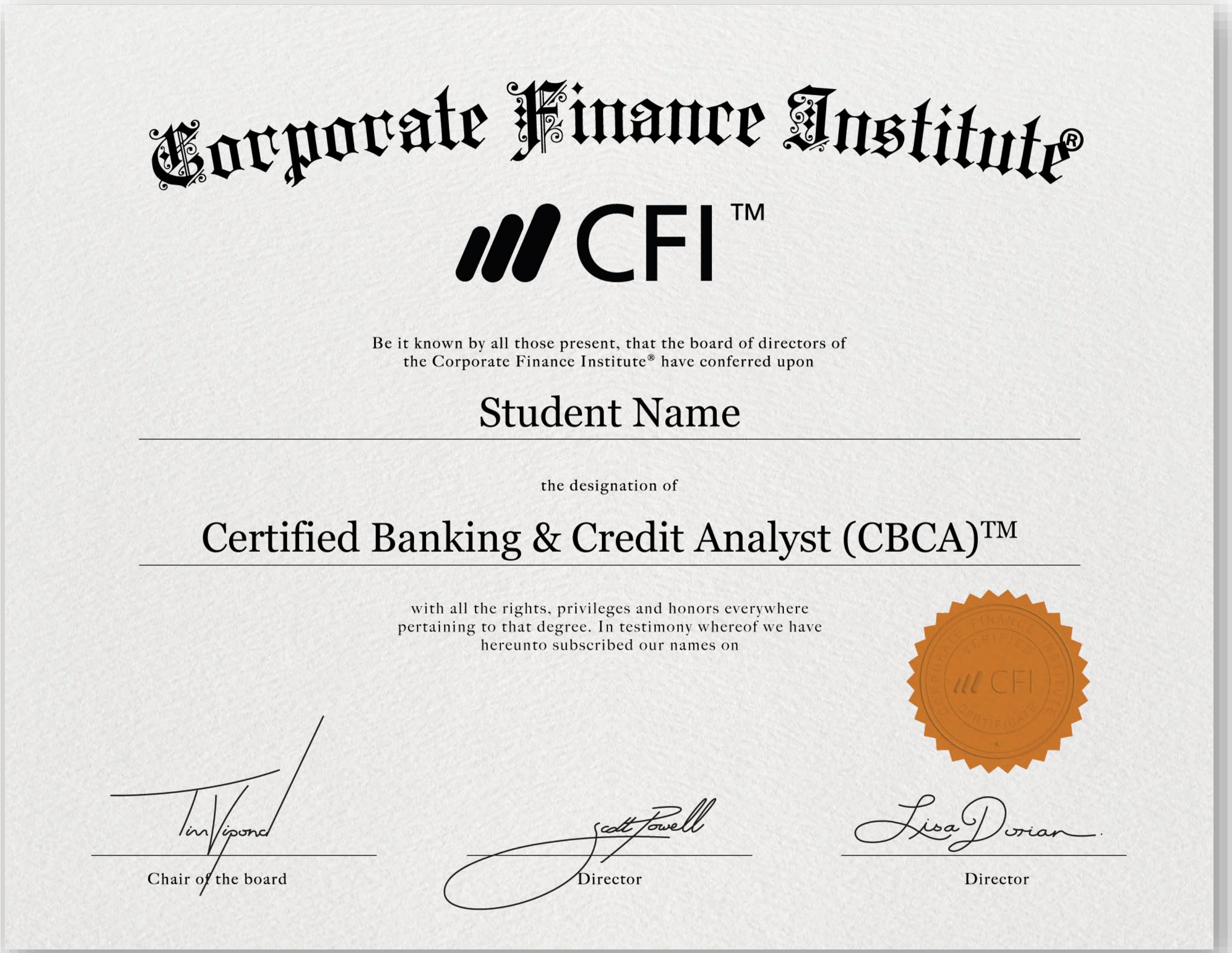
Conclusion

01. Distinguished between the three most common types of business structures

02. Learn the definition, advantages and disadvantages of each business structure

03. Understand how the legal structure of a company affects the lending process and lending decisions

CBCA Program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with all the rights, privileges and honors everywhere pertaining to that degree. In testimony whereof we have hereunto subscribed our names on

Chair of the board

Director

Director