Lesson 9.1 Types of Business Ownership

There are three major types of business ownership. They are sole proprietorships, partnerships, and corporations. Choosing the right form of business ownership is essential to a firm's success. There are advantages and disadvantages to each of the major forms of ownership. In addition to the three major types, there are also specialized forms of business organizations with which you should be familiar. Franchises, cooperatives, and non-profits will be defined later in this unit.

Lesson 9.2 Proprietorships

A **sole proprietorship** is a business owned by one person. Most proprietorships are small businesses such as jewelry stores, restaurants, hair-styling salons, and professional businesses such as physicians, attorneys, and accountants. More than two-thirds of U.S. businesses are operated as sole proprietorships. The sole proprietor has complete responsibility for business decisions and is usually the manager. From an accounting viewpoint, the proprietorship's accounting records do not include the proprietor's personal financial records. However, from a legal perspective, the business is the proprietor. You have **unlimited liability** or full responsibility for your company's debts. If you lose more money than you make, you have to make up the difference. You could lose your personal savings, your property, and even your car if your business cannot pay its debts.

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Owning your own business is easy to do. Depending on local laws, you may need only a license or permit to start a sole proprietorship. You get to be your own boss. You get to keep all of the profit, and you claim all the income or losses from the business on your personal tax return, meaning that all of the profits and losses from the business flow through the business to you—the sole proprietor.

On the other hand, there are disadvantages, too. You have to pay for everything yourself. You have to buy your own supplies, pay for advertising, rent office space, and pay taxes. You might have to use your personal savings or borrow money from the bank to start your business and keep it going. How is your record keeping? Do you have the business skills needed to operate a business? You might have to hire an office manager or accountant to help run your business.

Lesson 9.3 Partnerships

If you don't have the money to start a sole proprietorship, you could go into business with a partner. A **partnership** is a business owned and managed by a small group, often not more than two or three people, who become partners and share the risks and rewards. By written agreement, these partners share the profits or losses and have unlimited liability for the debts of their business. Many retail establishments and professional organizations are partnerships. Most are small or medium sized, but some are gigantic, exceeding 2,000 partners. Accounting treats the partnership as a separate organization, distinct from the personal affairs of each partner. However, from a legal perspective, a partnership is the partners. To start a partnership, you need to draw up a partnership agreement, which is a contract that outlines the rights and responsibilities of each partner.

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There are several advantages to a partnership. You might only need a license to start it; you pay taxes only on your personal profits; and it's easier to obtain capital. Your partners bring different skills to the business. The business can run more efficiently, and each partner has an incentive to do a good job.

Disadvantages include sharing profits, the potential for disagreements with a partner, and sharing unlimited legal and financial liability. If one partner makes a bad decision, all partners are equally responsible.

Lesson 9.4 Corporations

A **corporation** is a business owned by a number of people and operated under written permission from the state in which it is located. The written permission is called a **certificate of incorporation**. The corporation acts as a single individual on behalf of its owners. By buying shares of stock, people become owners of corporations. They are then known as **shareholders**, sometimes called stockholders. By law, the corporation is treated as one person. It is a legal entity with a life separate from its owners. It can own property, pay taxes, make contracts, and be sued. A corporation can have few owners or millions of owners, like Coca-Cola, IBM, Texaco, and General Motors.


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To raise money, you can sell stock or shares of ownership in your corporation. The new owners (stockholders) pay a set price for each share. For each share the stockholder owns, the stockholder will get a share of the profits and a vote on how the business is run.

You must also have a board of directors who control the corporation. They don't actually run the day-to-day business operations of the company, but they hire officers to do it. You get to pick the first board of directors, but each year the stockholders get to vote on them.

A major advantage of a corporation is its limited liability. If your company loses money, the stockholders lose only what they invested. Since your corporation exists separately from you, if it goes out of business, you can't have your personal property or savings taken away from you. Another advantage is that the corporation doesn't end if the owners sell their shares. As long as your business makes money, you can continue the company by reselling the shares. You can also raise more capital at any time by selling new shares.

A disadvantage of a corporation is that you often have to pay more taxes. The federal government and some state governments tax corporate profits. The owners are taxed on their income from the corporation, and the corporation itself has to pay taxes; this is known as double taxation. The government also closely regulates corporations. It's more difficult to start a corporation than a sole proprietorship or a partnership, and running it can be much more complicated.

Lesson 9.5 Specialized Forms of Business Organizations

As you can now see, choosing the right form of business ownership is central to a firm's success. In addition to the three major forms of ownership, there are some specialized types of business ownership structures: limited partnerships, limited liability partnerships (LLP), S corporations, limited liability companies (LLC), franchises, cooperatives, and non-profit corporations.

Limited Partnerships

Limited partnerships are similar to a regular partnership; they are not a taxable entity, and losses and gains are passed through to the partners. The difference is the two classes of partners. One class is called the limited partners which are typically investors. Limited partners do not make management decisions; the maximum liability is limited to their initial investment; and they can transfer ownership without dissolving the partnership. The other class of partners is called the general partners which typically are those who promote the business. General partners manage the day-to-day operations of the business, and they are personally liable for losses if the business fails. In order to change a partner, it must be written in an agreement signed by the partners.

Two main benefits of a limited partnership are to raise capital and to shelter income from taxation.

Limited Liability Partnerships (LLPs)

In the early to mid-1990's, many states passed legislation permitting the creation of a new business form called the limited liability partnership. LLPs are established according to the terms of the state enabling legislation. Typically, the partners must register with the state, pay a fee, include the term "limited" in their partnership name, and maintain appropriate professional liability insurance.

The purpose of an LLP is to allow those who want to operate a business in the form of a partnership to have the benefit of limited liability. LLPs remove a partner's personal liability for another partner's mistakes, misconduct, negligence, and wrongful acts. In other words, a partner's liability for the malpractice and negligence of another partner is limited to the partnership's assets, not personal assets.

S Corporations

An incorporated business can have the opportunity to form an S corporation. Federal tax laws, in certain situations, allow a business to escape most corporate income tax. The owners of the business would benefit by having limited liability without double taxation. In order for a corporation to qualify for an S corporation, they must have no more than 35 shareholders and meet other Internal Revenue Code requirements.

Lesson 9.5 Specialized Forms of Business Organizations (cont'd)

Limited Liability Companies (LLCs)

Most states have passed laws that authorize what are known as limited liability companies. **Limited Liability Companies (LLCs)** offer a business structure designed to combine the tax advantages of a partnership with the operating advantages of a corporation. **Professional Limited Liability Companies (PLLCs)** are designed for businesses that offer a professional service such as public accountants, attorneys, and physicians. Due to a 1988 ruling by the IRS, LLCs retain the limited liability of corporations but are treated as partnerships for tax purposes; therefore, they do not pay federal income tax as a separate entity. Instead, members report profits and losses from the business as part of their individual tax return.

An LLC is created by filing articles of organization with the Secretary of State and paying a fee. An LLC will operate according to an agreement among the members. It operates like a corporation as a separate entity and may own property, pay taxes, make contracts, and be sued. LLCs may be easily dissolved by death, bankruptcy, or retirement of a member. If unanimously agreed upon by remaining members, the business can continue operations. In some states, LLCs are limited to a lifetime of 30 years.

Limited Liability Companies have considerable advantages over other forms of business structures. LLCs are easier to create than limited partnerships and have no restrictions on the maximum number of investors like S corporations. Furthermore, LLCs protect their members from personal liability, unlike a limited partnership in which the general partners have unlimited liability.

Franchises

If you have stayed in a national motel chain, eaten in a fast-food restaurant, or purchased a car from a dealership, you have likely bought services and goods from a franchised business. A **franchise** is a written contract granting permission to sell someone else's product or service in a prescribed manner, over a certain period of time, and in a specified territory. The person or group who receive the franchise is called the **franchisee.** The parent company granting the franchise is called the **franchisor**. For example, if you decide to open a McDonald's restaurant, you are the franchisee. McDonald's, the parent company, is the franchisor.

The franchise agreement states the duties and rights of both parties. The franchisee agrees to run the business in a certain way. The name of the business, the products or services offered, the design and color of the building, the price of the products or services, and even the uniforms of the employees are determined by the franchisor.

Lesson 9.5 Specialized Forms of Business Organizations (cont'd)

Cooperatives

A **cooperative** is an organization owned and operated by its members for the purpose of saving money on the purchase of certain goods and services. A cooperative is like a corporation in that it exists as a separate entity from the individual businesses. You also need a government charter to start one. A cooperative can also sell stock and choose a board of directors to run it. Most of the profits a cooperative earns may be refunded directly to members at the end of the business year. Examples of cooperatives include: Ocean Spray, Welch's, Ace Hardware, and Blue Grass Energy.

Non-Profit Corporations

Not everyone goes into business to make a profit. You might want to start a business whose purpose is to help children, the poor, or animals. A **non-profit organization** is a type of business that focuses on providing a service rather than making a profit. Examples include: the American Red Cross, Meals on Wheels, and Boy Scouts of America. Private hospitals, schools, and museums can also be set up that way.

Like a corporation, a non-profit has to register with the government and might be run by a board of directors. Because the non-profit corporation does not make a profit, however, it doesn't have to pay taxes. Instead of investors, it relies on government grants and donations from businesses and individuals. Donors don't get dividends, but they can deduct their donations from their taxes.

Table 9-1

Comparison of the Three Basic Forms of Business Ownership

	Proprietorship	Partnership	Corporation
Owner(s)	Proprietor—there is only one owner.	Partners—there are two or more owners.	Stockholders—there are generally many owners.
Life of the organization	Limited by the owner's choice or death.	Limited by the owner's choices, or death.	Indefinite
Personal liability of the owner(s) for the business's debt	Proprietor is personally liable.	Partners are personally liable.	Stockholders are not personally liable.
Legal status of the organization	The proprietorship is the proprietor.	The partnership is the partners.	The corporation is separate from the stockholders.

Lesson 10.1 E-Commerce

The world's newest marketplace is not even an actual place. Thousands of businesses and individuals are taking advantage of e-commerce. E-commerce, or **electronic commerce**, is the buying and selling of goods and services via the Internet. Businesses can now directly reach customers anywhere in the world. Anyone with Internet access is now a potential customer. Internet access hasn't only changed the way products are sold, but it has changed the way business activities are conducted. Any company can go online to sell any product. Putting catalogs on the Internet saves a lot of money in printing and mailing costs, and the consumer can shop 24/7.


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Federal laws that protect Internet and TV shoppers are the same as those that govern purchases made by phone. The seller must send you the goods within 30 days or the specified time stated by the company. This clock begins as soon as the company receives your credit card number.

One of the main concerns to both the consumer and e-tailer would be privacy. How secure is the personal information given in a transaction? Many web browsers can automatically encrypt or scramble your personal and credit card information before it is sent over the Internet. Whenever possible, shop only from merchants that have a positive reputation with consumers. Keep a record of your receipt, online order confirmation, and merchant's Internet address. The American Institute of Certified Public Accountants (AICPA) helped to create WebTrust. WebTrust is an assurance service that uses technology, consulting, and audit skills to combat security and privacy issues when conducting shopping, banking, and other transactions online.