

4.1 Factors to Consider

LEARNING OBJECTIVE

1. Identify the questions to ask in choosing the appropriate form of ownership for a business.

If you're starting a new business, you have to decide which legal form of ownership is best for you and your business. Do you want to own the business yourself and operate as a sole proprietorship? Or, do you want to share ownership, operating as a partnership or a corporation? Before we discuss the pros and cons of these three types of ownership—sole proprietorship, partnership, and corporation—let's address some of the questions that you'd probably ask yourself in choosing the appropriate legal form for your business.

1. What are you willing to do to set up and operate your business? Do you want to minimize the costs of getting started? Do you hope to avoid complex government regulations and reporting requirements?
2. How much control would you like? Do you want to own the company yourself, or do you want to share ownership with other people? Are you willing to share responsibility for running the business?
3. Do you want to be the sole benefactor of your efforts or are you willing to share profits with other people? Do you want to be in charge of deciding how much of the company's profits will be retained in the business?
4. Do you want to avoid special taxes? Do you want to avoid paying "business" income taxes on your business and then paying "personal" income taxes on profits earned by the business?
5. Do you have all the skills needed to run the business? Do you possess the talent and skills to run the business yourself, or would the business benefit from a diverse group of owners? Are you likely to get along with co-owners over an extended period of time?
6. Should it be possible for the business to continue without you? Is it important to you that the business survive you? Do you want to know that other owners can take over if you die or become disabled? Do you want to make it easy for ownership to change hands?
7. What are your financing needs? How do you plan to finance your company? Will you need a lot of money to start, operate, and grow your business? Can you furnish the money yourself, or will you need some investment from other people? Will you need bank loans? If so, will you have difficulty getting them yourself?
8. How much liability exposure are you willing to accept? Are you willing to risk your personal assets—your bank account, your car, maybe even your home—for your business? Are you prepared to pay business debts out of your personal funds? Do you feel uneasy about accepting personal liability for the actions of fellow owners?

No single form of ownership will give you everything you desire. You'll have to make some trade-offs. Because each option has both advantages and disadvantages, your job is to decide which one offers the features that are most important to you. In the following sections we'll compare the three ownership options (sole proprietorship, partnership, corporation) on the eight dimensions that we identified previously: setup costs and

government regulations control, profit sharing, income taxes, skills, continuity and transferability, ability to obtain financing, and liability exposure.

KEY TAKEAWAYS

- Some of the questions that you'd probably ask yourself in choosing the appropriate legal form for your business include the following:
 1. *What are you willing to do to set up and operate your business?*
 2. *How much control do you want?*
 3. *Do you want to share profits with others?*
 4. *Do you want to avoid special taxes on your business?*
 5. *Do you have all the skills needed to run the business?*
 6. *Should it be possible for the business to continue without you?*
 7. *What are your financing needs?*
 8. *How much liability exposure are you willing to accept?*
- No single form of ownership—sole proprietorship, partnership, or corporation—will give you everything you want. Each has advantages and disadvantages.

EXERCISE

(AACSB) Analysis

Review the eight questions identified in this section that you'd probably ask yourself in choosing the appropriate legal form. Rate each of the questions using this scale: [1] not at all important; [2] not very important; [3] somewhat important; [4] very important; [5] extremely important. Select the two questions that are most important to you and the two questions that are least important to you, and explain your responses to these four questions.