

Business structures: a type of business entity that is legally recognized in a given jurisdiction.

In most countries, the basic forms of business structure are: sole trader, partnership, company.

The key elements that characterize a business structure are:

- The ownership structure (how many people own it),
- Owner liability (responsibility of the owners with respect to settlement of specific obligations),
- Funding opportunities (ability to raise additional fundings),
- Decision making responsibilities (who is making the most important decisions? Owners or other people),
- Taxation.

Sole trader is an individual who controls and manages a business. (impresa individuale)

Key features:

- One single owner (possibility to hire employees),
- The business is not a separate legal entity, which implicates that
- The owner is liable for all business debts.

Advantages:

- Quick, inexpensive and easy to establish,
- Inexpensive to wind down,
- Flexible reporting (no accounting standards),
- Owner has total autonomy over business decisions,
- Owner claims all the profits of the business and all after-tax gains if the business is sold.

Example

M. is the owner of M.'s, a small bar in the city center. During the first year of operation, the business was very successful. One day a customer approaches the counter to order a coffee and, unfortunately, slips on a recently washed area of the floor. The customer spend three weeks in the hospital and decides to begin proceedings against M.'s.

M. has insurance to cover such accident, but the insurance does not cover all costs. M. needs to mortgage his house to the bank in order to obtain a loan.

M. is forced to ask for a personal loan to get the money.

Disadvantages:

- The owner has responsibility for all business debts: it is Unlimited Liability.
- Limited by skills, time, and investment of owner,
- Restrictive structure due to non-legal status of the entity (difficult to raise additional finance/personal taxation),
- Business will cease to exist if the owner leaves, retires, or dies.

Partnership is an association between two or more people who:

- Carry on a business as partners (more responsible people),
- Share profits or losses (those include sharing according to each partner's capital contribution; splitting profits or losses equally between the partners; sharing them based on salary requirements).

Key features:

- Enables sharing of ideas, skills, and resources,
- Easy and cheap to establish,
- Some partnerships have a written agreement (it typically includes the name of the partnership, and it specifies the different contributions of the partners, either in cash or not).

Advantages:

- Relatively easy and simple to set up,
- Informal business structure - not bound by accounting standards,
- Ability to share capital, skills, talents, knowledge and workload between two or more people. (managerial vs. technical,...).

Disadvantages:

- Unlimited liability: in some countries there are limited liability partnerships or partnership in which some partners are not liable for business debts,
- Mutual agency: each partner is an agent for the business, having the right to enter into contract for the business: if one partner makes a bad business decision, all partners will have to pay for it,
- Disputes arise from profit sharing and decision making issues,
- Changing ownership is difficult: if one partner withdraws, then a new partnership agreement is needed (or a new partnership must be created).

Company is a business structure that has a separate legal identity from its owners and is taxed on its taxable income.

Key features:

- Owners of a company are known as shareholders,
- Independent legal entity (ex. Separate from the people who own, control, and manage it),
- Shareholders have limited liability – for the purchase price of their shares only (not company debts),
- A company has unlimited life – not dissolved when owners die or change.

Private company

A proprietary company is a company whose ownership is private: they cannot offer their shares to the public. The shares cannot be traded on stock exchange, shares of these businesses are less liquid and the values are difficult to determine. Common form of business structure adopted by small and medium enterprises (business entities that have revenues around millions of dollar but are not national enterprises).

Public company

A public company is a company whose ownership is dispersed among the general public in many shares, which are freely shared (public does not mean governmental). You can easily purchase the shares of the company. The shares of a public company are often traded on a stock exchange (they are listed public companies). The act of being listed allows the market to determine the value of the company through daily trading. Listed companies have better opportunities for fundraising. Public companies are a common form of business structures adopted by large multinational companies.

Advantages:

- Limited liability for shareholders,
- Corporate tax rates are usually lower than top personal tax rate,
- Business expansion networks are easier due to the legal structure,
- It can raise additional capital through public share offerings.

Disadvantages:

- More rules, costs, and requirements are needed to set up a company (money, ...),
- Must comply with complex company rules and other legal requirements (accounting standards),
- If a company is listed, it will have to bear with the cost of initial public offerings, increased disclosure of information, potential loss of control (hostile takeovers), separation of ownership and control.

Separation of ownership and control: in a company there are the most important stakeholders and other hundreds of small owners. Those small owners do not participate in the management of the operations of the company. The decisions are made by the board of directors, which operates on behalf of all the small owners of those businesses. The board of directors is chosen by the stakeholders based on the percentage owned by each figure. The managers that are part of the board of directors are often not the owners of the company, this produces an agency cost: Directors should act in the interest of the shareholders, but this is not always the case. To solve this issue shareholders need to set up mechanisms to ensure that managers make decisions that aligned with shareholder's objectives (ex. pay the managers with shares of the business).

The popularity of different business structures (Italy - 2011)

Sole traders 63% architects, lawyers

Partnerships 17% larger businesses

Companies 18%

Other 2%

SUMMARY

	Sole Trader	Partnership	Companies
Ownership structure	1 single owner	2 or more	Few (private) /Many (public)
Liability	Unlimited	Typically Unlimited	Limited
Funding opportunities	Limited (1 owner)	Limited (need to change the agreement)	Additional capital through public share offerings*
Decision making responsibility	Owner	Partners (mutual agency)	Board of directors Separation of ownership and control*
Tax	Owner taxed as individual tax payer	Partners taxed as separate individuals	Company taxed on profits

*Public companies