

## Forms of Business Organization

**Sole Proprietorship**-a business owned and operated by one person

### Advantages of Sole Proprietorships

1. Easy to organize-virtually no legal requirements
2. Freedom of action-the owner makes all the business decisions

### Disadvantages of Sole Proprietorships

1. Limited finances-limited to the finances of the owner and the owner's family and friends
2. Lack of management specialization-the owner has to make all the important decisions-which products to produce, which people to hire, what production techniques to use
3. Unlimited liability-if the business fails, and the assets are insufficient to pay the firm's creditors, the creditors can file claims against the owner's personal property.

**Partnership**-two or more individuals agree to own and operate a business together

### Advantages of Partnerships

1. Easy to organize-just a written agreement on responsibilities of the partners and the division of profits (losses)
2. Greater management specialization (relative to sole proprietorship)-partners can specialize according to their abilities
3. More financial resources (relative to sole proprietorship)-because there are more owners, financial resources are greater

### Disadvantages of Partnerships

1. Division of authority to make business decisions-leads to inconsistent corporate policy or inaction if there are major disagreements
2. Financial resources are still limited-the financial resources of three or four partners are not enough to grow into a big firm
3. Lack of continuity-the partnership is usually dissolved or reorganized when a partner dies or leaves the partnership
4. Unlimited liability-each partner is liable for all partnership debts even those resulting from decisions the partner didn't participate in. Creditors can file claims on the personal assets of partners.

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**Corporation**-a legal entity which can acquire resources, own assets, and sell products separate from the individuals that own the corporation

### Advantages of Corporations

1. Access to a large pool of capital-can raise lots of capital by selling stocks and bonds to a large group of people

2. **Limited liability**-the owners (stockholders) risk only what they paid for the stock. Creditors can sue the corporation as a legal person but not the stockholders
3. **Specialization**-because corporations can attract large amounts of capital, they are able to expand and thus use a specialized labor force and management specialists, leading to increased efficiency
4. **Perpetual life**-as a separate legal entity the corporation has a life separate from its owners and managers

#### Disadvantages of Corporations

1. **More difficult to organize**-have to obtain a charter and hire lawyers
2. **Management responsibility**-because the corporation is a legal entity, managers can avoid personal responsibility for questionable business practices
3. **Double taxation**-the corporate income tax taxes profits, and dividends are taxed as personal income
4. **Separation of ownership and control**-the stockholders own the corporation but hired managers run it. The interests of stockholders and hired managers may not coincide