

Identify the Advantages and Disadvantages of Partnerships

A BUSINESS PARTNERSHIP is a lot like a marriage. You and your partner may have different skills sets and experiences. In the end, however, you still have to enjoy being around each other every day to make the relationship work.



Objective:



Describe and explain partnerships.

Key Terms:



general partner
limited partner
partnership agreement
partnership

Understanding Partnerships

Suppose you plan to open a business. You know several people with whom you have worked that happen to be interested in becoming partners in this venture. What kind of person would be your ideal business partner? A partner with a lot of experience does not necessarily guarantee a good partner. The single most important characteristic of a good partner is the dynamics between you and the other person.

LEGAL PARTNERSHIP

A **partnership** is an unincorporated business with two or more owners. A partnership is often favored over a corporation for taxation purposes because the partnership structure does not generally incur a tax on profits before distribution to the partners.

General Partner

A partnership may be set up so all of the partners are general partners. A **general partner** is a person who has unlimited personal liability and takes full responsibility for managing the business. The law requires that all partnerships have at least one general partner.



FIGURE 1. A partnership requires good dynamics between you and your partner.

Limited Partner

A partnership may be set up so partners are limited partners. A

limited partner is a partner whose liability is limited to his or her investment. A limited partner cannot be actively involved in managing the business.

ADVANTAGES AND DISADVANTAGES OF A PARTNERSHIP

There are several advantages and some disadvantages of a partnership.

Advantages

A partnership is easy to start. You might only need a license or a permit and a partnership agreement to begin. A partnership has limited government regulation. Initial costs are relatively low compared to other types of ownership, and the costs can be shared with partners. Banks are more willing to loan money to a partnership. In addition, general partners have complete control. They share ideas and bring different skills and experiences to the business. They share investment capital more easily and in greater amounts. Also, the taxes are low.



DIGGING DEEPER...

UNCOVERING ADDITIONAL FACTS: The Partnership Agreement

Locate an example of a general partnership agreement on the Internet. A sample general partnership agreement form can be found at <http://www.medlawplus.com/legalforms/instruct/sample-partnershipagreement.pdf>. Print out the form and identify the components.

Then consider your strengths and weaknesses as a business partner. What type of personal dynamics would your ideal partner need to possess? What skill set would be most helpful for the person to bring to the partnership?

Disadvantages

A partnership is difficult to dissolve. Personality conflicts may occur. In addition, partners share risks and profits. Also, partners have unlimited legal and financial liability.

TABLE 1. Partnership Chart

Advantages	Disadvantages
Easy to start	Difficult to dissolve
Limited government regulation	Personality conflicts
Relatively low initial costs	Share risks and profits
General partners with complete control	Unlimited legal and financial liability
Shared ideas; different skills and experiences	
Share investment capital more easily and in greater amounts	
Taxes are low	

A SOLE PROPRIETORSHIP VERSUS A PARTNERSHIP

There are many similarities between a sole proprietorship and a partnership.

- ◆ Both have start-up costs that are relatively low.
- ◆ Both have unlimited liability. Sole proprietors are liable for all claims against the business. General partners are liable for all claims against the business; limited partners are liable only for the amount of their investment.
- ◆ Taxation: The profits or losses pass through to the owner to be taxed at his or her individual tax rate.
- ◆ Management control: A sole proprietor has full control; general partners have full control.
- ◆ Number of owners: A sole proprietorship has one owner; partnerships have two or more owners.
- ◆ Profits: A sole proprietor keeps all the profits; partners share the profits.
- ◆ Decisions: A sole proprietor makes all the decisions; partners share the responsibility of making decisions.

TABLE 2. Similarities Between a Sole Proprietorship and a Partnership

Similarities	Sole Proprietorship	Partnership
Simple to start	X	X
Low initial cost	X	X
Limited government regulation	X	X
Profits go to owner(s)	X	X
Taxes are low	X	X

TABLE 3. Differences Between a Sole Proprietorship and a Partnership

Differences	Sole Proprietorship	Partnership
Number of owners	One	Two or more
Profits	Owner keeps all profits	Partners share the profits
Decisions	Owner makes all decisions	Partners share the responsibility of making decisions

MAKING A PARTNERSHIP WORK

A partnership has the greatest chance of survival when partners share business responsibilities, record everything in writing, and communicate openly and honestly about how the business is doing.

Partnership Agreement

Partners should establish a partnership agreement in advance. The law does not require a partnership to be based on a written agreement. However, a well-constructed partnership agreement can alleviate many problems.

Purpose of the Agreement

A **partnership agreement** is the rights and responsibilities of each of the owners in writing. It identifies the following:

- ◆ Name of the business or partnership
- ◆ Filing of an application for a Certificate of Doing Business Under an Assumed (DBA) name when using a name other than the name of the owner(s)
- ◆ Names of the partners

- ◆ Type and value of the investment each partner contributes
- ◆ Managerial responsibilities to be handled by each partner
- ◆ Accounting methods to be used
- ◆ Rights of each partner to review and/or audit accounting documents
- ◆ Division of profits and losses among the partners
- ◆ Salaries to be withdrawn by the partners
- ◆ Duration of the partnership
- ◆ Conditions under which the partnership can be dissolved
- ◆ Distribution of assets upon dissolution of the partnership
- ◆ Procedure for dealing with the death of a partner



FIGURE 2. Having a partnership agreement can prevent problems in the future.

Summary:



The single most important characteristic of a good partner is the dynamics between you and the other person. Partnerships are unincorporated businesses with two or more owners. The partners can be classified as general partners or limited partners. Partnerships are simple to create, and partners are given a great deal of control. However, partnerships can be difficult to dissolve, and conflicts between partners do occur.

There are many similarities between sole proprietorships and partnerships. Both have relatively low start-up costs. Both have unlimited liability. The differences occur when speaking of profits, risks, and control. With sole proprietorships, the risk, profits, and decision-making rests solely with the business owner. With partnerships, the roles are different depending upon the agreements that are in place. Partnerships have the greatest chance of survival when partners share business responsibilities, record everything in writing, and communicate openly and honestly about how the business is doing.

Checking Your Knowledge:



1. List two ways in which sole proprietorships and partnerships are similar.
2. List two ways in which sole proprietorships and partnerships are different.

3. How can a partnership agreement improve the probability of success in a partnership?
4. What is the single most important characteristic of a good partner?
5. Define the term “partnership.”

Expanding Your Knowledge:



Visit your local community college or Chamber of Commerce and ask about resources for small business start-ups and small business incubators. Specifically, ask about information regarding sole proprietorships and partnerships. Often the workers in these resource areas are retired executives or retired small business owners. Conduct an interview about the person’s experiences with partner personality dynamics.

Web Links:



Partnerships

<http://www.irs.gov/businesses/small/article/0,,id=98214,00.html>

Creating a Winning Business Partnership

<http://sbinformation.about.com/cs/bestpractices/a/aa030203a.htm>

Sample Partnership Agreement Form

<http://smallbusiness.findlaw.com/business-forms-contracts/business-forms-contracts-a-to-z/form4-1.html>

The General Partnership

<http://www.quickmba.com/law/partnership/general/>