

# Identify the Advantages and Disadvantages of Corporations

**I**F YOU HAVE an idea for a business, how do you get started? What type of business model should you use? Your personal financial needs and wants are the guiding principles you use to select the best model for you. It may not be the best model for someone else.



## Objective:



1. Define a corporation.
2. Identify the advantages and disadvantages of a corporation.
3. Examine the similarities and differences between a sole proprietorship, a partnership, and a corporation.
4. Recognize different types of corporations.

## Key Terms:



corporate charter  
corporation  
limited liability  
shares of stock  
stockholders

## Defining a Corporation

Suppose your sporting goods store has grown and you want to add more brands of athletic shoes and buy new equipment. You need more capital, but you do not want to borrow more money. What can you do? One consideration is to form a corporation. A **corporation** is a business that is registered by a state and that operates apart from its owners.

## CORPORATE CHARTER

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To form a corporation, a corporate charter is needed from the state in which the headquarters is located. A **corporate charter** is a license to run a corporation.

## STOCK

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Ownership or equity in a corporation is represented by **shares of stock**—units of ownership. Therefore, to raise money, you can sell stock or shares of ownership in the corporation. The new **stockholders** (owners of stock) pay a set price for each share. For each share of common stock, the stockholder receives a share of the profits and a vote on how the business is run.

## BOARD OF DIRECTORS

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A board of directors controls the corporation. It does not run the day-to-day business operations of the company, but it does hire officers to handle such tasks.

## BUSINESS TRANSACTIONS

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A corporation can purchase goods, sue and be sued, and conduct any type of business transaction.



**FIGURE 1.** A board of directors hires other people to handle the day-to-day business operations.

## Advantages and Disadvantages of a Corporation

Just like other business types, a corporation has aspects about its design that are beneficial and challenging.

## ADVANTAGES

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The obvious advantages are status, limited liability, and the ability to raise capital via the sale of stock.

## Status

Status is certainly an advantage. An officially incorporated business has a more professional appearance. It holds regular meetings and appoints officers to help the business run smoothly. This can help a business obtain a loan, which is critical for expansion and competition.

## Limited Liability

Another benefit of corporate status is that corporate shareholders have **limited liability**—a situation in which the shareholders cannot lose more than their invested assets. Therefore, if the corporation goes out of business, the investors cannot have their personal property or savings taken away from them.

## Stock Sales and More

A corporation can raise investment money by selling stocks. A corporation also has a continuous life (perpetual existence) regardless of changes in ownership. A corporation is structured to accommodate employee benefits. It can offer pension plans, retirement options, and profit-sharing plans.

## DISADVANTAGES

A corporation is expensive to set up, usually between \$500 and \$2,500. In addition, corporate income is heavily taxed because it is subject to double taxation on earnings. The corporation pays taxes on its earnings, and the stockholders pay taxes on dividends they receive. Also, the government closely regulates corporations.



## DIGGING DEEPER...

### UNCOVERING ADDITIONAL FACTS: Your Small Business

All successful businesses start with a carefully written plan. If you are interested in a sole proprietorship, a partnership, or a corporation, you must start with your business plan. Use the U.S. government's small business Web site at

<http://www.sba.gov/smallbusinessplanner/index.html>

You will find resources for all stages of the business lifecycle. Careful planning for every stage of the business is vital to your future and that of your business. Think of the business plan as your road map to success.

## Similarities and Differences Between a Sole Proprietorship, a Partnership, and a Corporation

Similarities and differences exist when comparing a sole proprietorship, a partnership, and a corporation. A sole proprietorship and a partnership are simple and easy to start; a corporation is much more complex to start. Decisions are made by one person in a sole proprietorship. However, decisions are made by more than one person in a partnership and by many people in a corporation.

There is a low initial cost with the sole proprietorship and the partnership, but the corporation start-up costs range higher. There is no limited liability with the sole proprietorship and the partnership, but there is limited liability with a corporation.

Limited government regulation exists with the sole proprietorship and the partnership, not with the corporation. However, corporations can raise capital by selling stocks, which is not a possibility with the sole proprietorship or the partnership. Yet there is double taxation of profits with the corporation but not with the sole proprietorship or the partnership.



FIGURE 2. Decisions are made by many people in a corporation.

## Types of Corporations

There are different types of corporate models: the C-corporation, the subchapter-S corporation, and the nonprofit corporation.

### C-CORPORATION

A C-corporation is the most common corporate form. It can protect the entrepreneur from being sued for the actions and debts of the corporation.

## SUBCHAPTER-S CORPORATION

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The subchapter-S corporation is a corporation taxed like a partnership. The profits are taxed only once at the shareholder's personal tax rate. Subchapter-S corporations can have no more than 75 stockholders, and the stockholders must be U.S. citizens.

## NONPROFIT CORPORATION

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A nonprofit corporation makes money for reasons other than owner profits. A nonprofit business can make a profit. However, the profits must remain within the company and must not be distributed to shareholders.

### Summary:

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A corporation is a business registered by a state that operates apart from its owners. To form a corporation, a corporate charter is needed from the state in which the headquarters is located. A corporate charter is a license to run a corporation.

Just like other business types, a corporation has aspects about its design that are beneficial and challenging. The obvious benefits are status, limited liability, and the ability to raise capital via the sale of stock. A corporation, however, is expensive to start up.

Many similarities and differences can be found when comparing sole proprietorships, partnerships, and corporations. In the general sense, corporations are more complex and more costly, but they can offer more protection and more benefits. Different types of corporate models are the C-corporation, the subchapter-S corporation, and the nonprofit corporation.

### Checking Your Knowledge:

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1. Define "corporation."
2. Define "limited liability."
3. Define "stockholder."
4. Explain some of the benefits of a corporation.
5. Explain some of the challenges of a corporation.

## Expanding Your Knowledge:

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The best way to learn more about corporations and the different models is to do some research. Use the Internet to design a database to include the name, address, phone number, and type for 10 corporations. Analyze your results.

## Web Links:

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### Corporation Types

<http://www.companiesinc.com/corporation/types.asp>

### Incorporation FAQ

<http://www.4inc.com/incfaq.htm>

### Starting Up: Practical Advice for Entrepreneurs

<http://web.mit.edu/e-club/hadzima/subchapter-s.html>

### Five Types of 501(c) 3 Non-Profit Organizations

[http://blogs.findlaw.com/free\\_enterprise/2009/08/5-types-of-501c3-non-profit-organizations.html](http://blogs.findlaw.com/free_enterprise/2009/08/5-types-of-501c3-non-profit-organizations.html)