A COMPREHENSIVE GUIDE TO BUSINESS STRUCTURES

ABSTRACT

Choosing a business structure is a key step when establishing a new business. The structure of a business can have implications for several essential elements of the way the business operates, including taxes and personal liability.

Learning about the most common business structures can help you determine the best choice for your new business. In this article, we define what a business structure is, review common business structures and their advantages and explore what to consider when choosing a business structure.

INTRODUCTION

In this blog, let's take you through what a business structure is, how to choose one, and what all the different types of business structures are.

Are you thinking of starting your own business? Before you start thinking about business plans and product design and marketing initiatives, you need to understand business structure.

I. What is a Business Structure?

Choosing a business structure will have long-term consequences for you and your business, and will affect how you structure your organization, how you pay taxes, and how liable you may be for business losses and debts. A lot goes into this decision, so it's crucial to know what your options are.

In this blog, we'll take you through what a business structure is, how to choose one, and what all the different types of business structures are.

Business structure definition

A business structure refers to how a business is organized, according to its legal status. Your business structure will state who owns the company, how its profits are distributed, how it will be taxed, and what roles will perform which tasks.

Different types of business structure

There are several different types of business structures you can choose from. Each different type of business structure listed here may have different requirements depending on where your business is located.

Sole proprietorship

A sole proprietorship creates a business that is fundamentally tied to the person who owns the business, both legally and professionally. There is no legal distinction between the owner of the business and the business itself. This type of business structure is often chosen by individuals looking to start a small business that they can run on their own, or with the help of a few employees.

Benefits of creating a sole proprietorship:

- No corporation tax: Sole proprietors are not incorporated, so they don't have to pay corporation tax.
- Direct access to profits: Because there is no legal distinction between the business and the person running it, all the company's profits are your profits.
- Easy to set up: Sole proprietorships are easy to set up, don't require much paperwork, and the cost of doing so is much lower than other business

structures. A large amount of paperwork comes when owners have to establish separate liability from their companies.
- No reporting: Depending on where you are located, you may need to file reports with your government to ensure your lists of members and managers are up to date.
- No formal business requirements: As a sole proprietor, you are not required to undertake certain operations other business structures are required to, including board meetings and formal reviews.

Partnership

A partnership is exactly the same as a sole proprietorship, only with more than one owner. You often see this type of business structure in small firms like law firms, ad agencies or something similar.

Benefits of creating a partnership:

- Shared liability: Compared to operating your own business as a sole proprietor, a partnership offers mutual support and a more evenly spread liability if things go wrong.
- Experience: Each partner will bring their shared experience and contacts to their role, which will benefit the company
- Better decision-making: Rather than relying solely on one person to make decisions, responsibility will be shared and more experience and perspectives can be brought to bear on a problem.
- More money, more capital: The more partners there are, the more capital the company has to fund its operations.

Limited liability company

Unlike a partnership or sole proprietorship, a limited liability company (LLC) creates a legal distinction between the owners and the company. However, it still has flow-through income taxation (where the income of the business is filed as part of the owner's personal income and not taxed separately).

Benefits of creating a limited liability company:

- Choice in taxation: As an LLC, you have the choice to be taxed as a corporation, sole proprietor, or partnership.
- Easy to set up: LLCs are almost just as easy to set up as a sole proprietorship or partnership.
- Scope in shareholders: When you create an LLC, you can do it with just one person or with multiple people.
- Limited liability: Because creating an LLC creates a separate legal entity from the owners, the owners cannot be liable for any debts or losses incurred by the company.

- More money: Members can receive revenues and write off forfeitures that are larger than their individual ownership percentage.

Corporation

A corporation is a legal entity separate from its owners. Corporations can be owned by individuals or other entities. Ownerships can be bought, sold, or transferred via the exchange of stock. A corporation can enter into litigation on its own, protecting shareholders from personal liability.

Corporations have a far more formal structure than other business structures. Depending on where it is incorporated, a company will need to follow certain requirements, such as filing articles of incorporation, creating corporate bylaws, and more.

Benefits of creating a corporation:

- Personal liability protection: The owners of a company cannot be sued or held liable for the actions or losses of the company.
- Business security and perpetuity: Ownership of a corporation is very flexible since shares can be bought or sold.
- Access to capital: Corporations can easily raise capital by creating a selling stock.

II. The Basics of Corporate Structure, With Examples

What Are the Basics of Corporate Structure?

CEOs, CFOs, presidents, and directors—what's the difference? Modern corporations have a variety of different leadership positions, with different responsibilities. Most public companies have a two-tier corporate hierarchy: the management team reports to the board of directors, who in turn are responsible to the shareholders.

Understanding the Basics of Corporate Structure

A company may choose to follow several models of corporate governance. These can have traditional, pyramid-shaped leadership roles, or have flexible leadership structures. Most public corporations consist of a board of governors or directors, and one or more executives. In some cases, the same person may occupy multiple positions.

These bodies exist because the evolution of public ownership has created a separation between ownership and management. Before the late 19th century, many companies were small, family-owned, and family-run. Today, many are gigantic international conglomerates with thousands of shareholders.

The modern system of corporate governance exists to ensure that companies represent the interests of their owners stockholders. The board of directors is elected by the shareholders of the corporation. They are responsible for overseeing the work of the management team, including the chief executive officer and other C-suite executives.

The Board of Directors

Elected by the shareholders, the board of directors is made up of two types of representatives. The first type involves inside directors chosen from within the company. This can be a CEO, CFO, manager, or any other person who works for the company daily.

The other type of representative encompasses outside directors, chosen externally and considered independent of the company. The role of the board is to monitor a corporation's management team, acting as an advocate for stockholders. In essence, the board of directors tries to make sure that shareholders' interests are well served.

Board members can be divided into three categories:

1. Chair: Technically the leader of the corporation, the board chair is responsible for running the board smoothly and effectively. Their duties typically include maintaining strong communication with the chief executive officer and high-level executives, formulating the company's business strategy, representing management and the board to the general public and shareholders, and maintaining corporate integrity. The chair is elected from the board of directors.

2. Inside directors: These directors are responsible for approving high-level budgets prepared by upper management, implementing and monitoring business strategy, and approving core corporate initiatives and projects. Inside directors are either shareholders or high-level managers from within the company.

3. Inside directors help provide internal perspectives for other board members. These individuals are also referred to as executive directors if they are part of the company's management team.

4. Outside directors: While having the same responsibilities as the inside directors in determining strategic direction and corporate policy, outside directors are different in that they are not directly part of the management team. The purpose of having outside directors is to provide unbiased perspectives on issues brought to the board. By being unbiased and detached from management, outside directors provide independent representation of shareholders, broaden the company's thinking beyond management's

perspective, and help to insure transparency, accountability, and ethical conduct.

The Management Team

As the other tier of the company, the management team is directly responsible for the company's day-to-day operations and profitability. They often work with lower-level staff managers, who, in turn. convey company orders to supervisors. Supervisors then work directly with the junior staff members frequently located in the bullpen.

Chief Executive Officer (CEO): As the top manager, the CEO is typically responsible for the corporation's entire operations and reports directly to the chair and the board of directors. It is the CEO's responsibility to implement board decisions and initiatives, as well as to maintain the smooth operation of the firm with senior management's assistance.

Often, the CEO will also be designated as the company's president and, therefore, be one of the inside directors on the board (if not the chair). However, it is highly suggested that a company's CEO should not also be the company's chair to ensure the chair's independence and clear lines of authority.

Chief Operations Officer (COO): Responsible for the corporation's operations, the COO looks after issues related to marketing, sales, production, and personnel. Often more hands-on than the CEO, the COO looks after day-to-day activities while

providing feedback to the CEO. The COO is often referred to as a senior vice president.

Chief Financial Officer (CFO): Also reporting directly to the CEO, the CFO is responsible for analyzing and reviewing financial data, reporting financial performance, preparing budgets, and monitoring expenditures and costs.

The CFO is required to present this information to the board of directors at regular intervals and provide it to shareholders and regulatory bodies such as the Securities and Exchange Commission (SEC). Also usually referred to as a senior vice president, the CFO routinely checks the corporation's financial health and integrity.

Special Considerations

When you are researching a company, it's always a good idea to see if there is a good balance between internal and external board members. Other good signs are the separation of CEO and chair roles and a variety of professional expertise on the board from accountants, lawyers and executives.

It's not uncommon to see boards that consist of the current CEO (who is chair), the CFO, and the COO, along with the retired CEO, family members, etc. This does not necessarily signal that a company is a bad investment, but as a shareholder, you should question whether such a corporate structure is in your best interests.

What Does a Board of Directors Do?

A company's board of directors is responsible for setting the long-term strategic direction of a company or organization. This can include appointing the executive team, setting goals, and replacing executives if they fail to meet expectations.

In public companies, the board of directors is also responsible to the shareholders, and can be voted out in a shareholder election. Board members may represent major shareholders, or they may be executives from other companies whose experience can be an asset to the company's management.

What Does a Company President Do?

In large companies, the CEO is the highest-ranking executive and the president is the second-highest. However, it is also possible for one person to hold both offices, or for a company to have a CEO and no president. A president is typically responsible for the day-to-day operations of a company, and their role may overlap with a chief operating officer.

What Is the Difference Between a CEO and Chair of the Board?

In large corporations, the chairperson presides over the board of directors, ensuring effective governance and strategic planning. The management team, including the CEO, is responsible for executing that strategy and meeting the goals set by the board. It is possible for one person to hold both roles, although in larger companies they tend to be separate.

Together, management and the board of directors have the ultimate goal of maximizing shareholder value. In theory, management looks after the day-to-day operations, and the board ensures that shareholders are adequately represented. But the reality is that many boards include members of the management team.

III. 5 Common Business Structures and the Advantages of Each

Common business structures

Below are five of the most common business structures to consider when establishing a business, along with the advantages of each:

1. Sole proprietorship

In a sole proprietorship, one person owns the business and runs its operations. Advantages of a sole proprietorship include:

- Complete control: As the sole owner, you have authority over all business decisions and don't need to consult with other partners, directors or shareholders.
- Easier startup: Establishing a sole proprietorship doesn't require forms or payment of government fees. This can help simplify the process and keep startup costs down.
- Simple tax reporting: Because the business isn't legally a separate entity, the business' expenses and income will be included on your personal income tax. As an added benefit, you can use business losses to balance out the income you earned, which can lead to a higher tax return.
- Privacy: Sole proprietorships aren't required to file annual reports with state or federal governments. Therefore, the business won't be subject to the same public disclosure as it might be in other structures.

2. Partnership

In a business partnership, two or more people own and operate the business. A partnership is one of the simplest business structures for multi-owner companies or professional groups. Advantages of a partnership structure include:

- Simple startup: Establishing a partnership doesn't require paperwork to be filed with the federal government, though there may be a few forms to file at the state level.
- Few tax forms: In a partnership, the business doesn't pay tax on its income, which means you don't need to file business tax returns. Instead, the profits and losses pass through to the individual partners' personal income tax returns.
- Shared finances: Having a co-owner can reduce the financial burden of starting a company because the partners can split purchases and overhead costs. Banks may also be more likely to offer loans to multi-owner businesses, which can help in the early stages of financing the business.
- Combined knowledge: Having a partner can help grow your business by providing skills or expertise in areas where you're less familiar. A partner can also bring a different perspective to important decisions around operations.

3. Corporation

A corporation is an entity that exists independently of its owners, making this business structure more complex and expensive to establish. Advantages of corporations include:

- Liability protection: Owners aren't responsible for a corporation's debts, so their personal assets are protected. As an independent entity, a corporation can file and receive lawsuits, but owners aren't liable for such legal actions.
- Business continuity: The corporation business structure bases ownership on the percentage of stock held, so the business can run without disruption even if a shareholder leaves or sells their shares. This allows for more flexibility when transferring ownership.
- Quick capital: Corporations can raise funds by selling company stock and offering shares as employee benefits. This can help grow the business and support it in times of need.
- Tax exemptions: Although owners pay a double tax on business earnings, corporations can deduct certain benefits they provide to employees, such as retirement plans, health insurance premiums, life insurance and other related expenses.

4. S corporation

The S corporation business structure offers the liability protection of a corporation plus added tax benefits. Advantages of the S corporation business structure include:

- No double taxation: Business profits and losses pass directly to the shareholders' personal incomes and appear on their tax returns. This means the S corporation has one level of federal tax to pay and shareholders aren't subject to corporate tax rates.

- Liability protection: Shareholders in S corporations aren't personally responsible for the business's debts and liabilities. This protects their personal assets, such as bank accounts or property, from creditors.
- Simple ownership transfers: In an S corporation, shareholders can sell their shares without tax consequences. Furthermore, this business structure can continue to run undisturbed when losing a shareholder, just like other corporations.
- Cash method of accounting: Although a corporation must use the accrual method, S corporations without inventory can use the more simple cash method. In cash accounting, you record income when you receive it and expenses when you pay the invoice.

5. Limited liability company

A limited liability company (LLC) is a hybrid business structure that takes advantage of certain aspects from both partnerships and corporations. Advantages of the LLC business structure include:

- Limited liability: Because an LLC is an independent entity, owners aren't personally responsible for debts or lawsuits against the company. If the business goes bankrupt, personal assets have protection, though any money invested in the business may be lost.
- Pass-through taxation: Rather than paying corporate taxes, the company's income and expenses pass directly to the owners' personal tax returns, and they pay tax on the profits. Because the owners are considered self-employed, they may claim the self-employed tax credit, but it's their responsibility to contribute to Medicare and Social Security.

Frequently asked questions

How do I acquire funding to start a business?

The way in which you acquire funding for a business depends on the business structure you want the company to have. For example, if you're starting a sole proprietorship, you could use your personal savings or raise capital through crowdfunding. If you're starting an LLC or a larger business, you might seek funds via a government-sponsored business loan.

What's the difference between a C corporation and an S corporation?

The main difference between these two types of corporations is their tax regulations. While a C corporation is the customary corporation type according to the Internal Revenue Service, an S corporation has unique tax advantages because it avoids the double taxation that C corporations are required to fulfill.

What are the benefits of starting a closed corporation?

A closed corporation operates much like a normal corporation, but it doesn't have to maintain a board of directors or organize yearly meetings for its shareholders. In most states, closed corporations have fewer than 35 shareholders, so it can be easier for a business leader to manage shareholders' interests.

IV. How to Choose the Best Legal Structure for Your Business

Businesses are built with a lot of aspirations and determination by entrepreneurs to bring about change or get noticed. However, before giving wings to their dreams, they need to understand the legal implications of the establishment type they want. Australian businesses must comply with legal regulations to become eligible to operate in their chosen city or suburb. They have to define their legal identity to become a part of the commercial sector.

The legal structure of the business outlines its legal obligations that must be adhered to while performing the operations. It also lays down the restrictions related to the business type and the rights of the entity. Thus, new entrepreneurs who plan to buy a Sydney business for sale must pay attention to the type of entity they want to establish. Here are a few tips to help you choose the best legal structure for your business. These will help you make the right choice.

1. Different Types of Legal Business Structures

A commercial entity can adopt four types of legal business structures. These include:

A Sole Trader Business Structure

New entrepreneurs can start their businesses as sole traders because it is easy to establish and operate. The sole trader business structure is run by an individual who is legally accountable for the debts and losses incurred by the entity. The individual has complete control over the decisions and operations and can file tax returns using the individual tax file number. They can hire employees and have to get the Australian Business Number (ABN). They have to register the business name only if it differs from their name.

A Partnership Business Structure

A partnership is owned by two or more individuals who are equally responsible for the losses and share the profits. It can be easily set up like a sole trader business structure and is controlled by the partners. It can be dissolved quickly, and each partner must acquire the ABN to form the partnership. This structure can be of two types – general and limited. In a general partnership, all partners are equally responsible for managing the operations and have unlimited liability for debts. In a limited partnership, one or two partners have limited liability for debts, whereas others have unlimited liability. The liability limit is decided by the investment made by the partner in the business.

A Company Business Structure

A company is set up as a separate legal entity, wherein the owner is not liable for the debts and obligations of the business. The company has rights similar to those enjoyed by a natural person and can be sued or incur losses. It is owned by shareholders and run by the directors but is more challenging to set up than a partnership or a sole trader entity. Often, budding entrepreneurs purchase an

existing business for sale Sydney that has been complying with the Corporations Act 2001 to avoid all the registrations and licensing obligations.

A Trust Business Structure

A trust is a structure in which the trustee manages the business on behalf of the members of the trust (beneficiaries). The trustee can be an individual or a company, which is liable for losses and responsible for income. It is challenging to set up a trust, and the trustee has control over the distribution of beneficiaries.

2. Comparing the Different Business Structures

Budding entrepreneurs who plan to set up a business must know that they must make the minimum investment to establish a sole trader structure and the maximum for a trust. Partnerships and companies lie in the medium to high investment range. Tax and legal obligations are low for sole traders and partnerships.

However, companies have medium tax obligations and high legal obligations, while trusts have high tax obligations and medium legal obligations. A sole trader does not require a separate business account or submit extra reports and has full control over the entity. All other business structures must have a separate business account and follow reporting obligations.

3. Changing Your Business Structure

Many entrepreneurs start as sole traders and then change the structure to a company. It is possible to alter the legal structure of the business after its

establishment to increase revenue or make way for changes needed to stay ahead of competitors. Most entrepreneurs opt for this change when they start growing.

However, if you purchase a business for sale in Sydney, which is a company, you do not have to get into these details. A sole trader can be changed to a partnership, and a partnership can be changed to a company. Usually, changing the legal structure requires a new ABN and the transfer or cancellation of the old business name with the Australian Securities and Investments Commission (ASIC).

4. Most Popular Business Structure

Although companies have a complex set-up process and extensive legal obligations, they are the most commonly registered businesses in the country. They are more popular because they have a prevalent business structure that everyone in the industry understands. The shareholders have limited liability, and the profits generated by the business can be divided among them as dividends or invested back into the company.

Securing funding for a company with a good credit score is easier. A company can be easily sold to interested buyers looking for a Sydney business for sale. Another benefit of owning a company is that the losses can be carried forward indefinitely to offset against estimated profits.

5. Choosing the Best Legal Business Structure

The legal business structure must be chosen according to the needs of the entity, such as the licences required for selling the products and the capacity of the venture to pay the taxes. Entrepreneurs can also choose the structure based on the control they want over the entity.

In addition, the financial investment required for setting up the legal business structure and the responsibility for debts and losses must be evaluated before

proceeding. Since the legal structure can be changed at any time, you can make the initial decision based on your needs at that juncture.

Starting a business requires planning and following legal obligations. The first thing to decide is the venture's legal structure to ensure it can accomplish the business goals and is managed effectively by the owner. Thus, entrepreneurs should choose the structure after careful reflection of the implications.

V. Time For Change: How To Successfully Change Your Organizational Structure

Change is one of the hardest things to accomplish in an organization, and structural organizational change is one of the most difficult types to achieve successfully. This is especially true in the technology industry. Change is often a result of new opportunities, leadership updates and the need to drive cultural change or accountability. Altering an organization's structure requires careful planning, but it can prove the greatest driver of success.

The following are the three main steps of organizational change:

1. Understanding Your Current Problems And Goals

When planning changes, you must fully understand your current problems and your intended solutions. This step is important for the success of the change itself, but it

also allows you to successfully communicate your reasons for change in the next step.

All organizations undergo change. What was previously working for an organization may no longer be. But how do you identify problems and find solutions? The first step is often to examine your organizational KPIs. If the organization isn't meeting its KPIs, why? Ask the staff of an organization for their opinion on what is working and what isn't, using small group discussions and surveys. Once you identify weaknesses in your current structure, you can then turn these into goals for the future organization.

Structural organizational change is often targeted to achieve greater accountability for success, greater focus and accountability division — for success across a broader range of leaders. One outcome you may seek is adherence to best-practice organizational metrics. If this is the case, make sure you are documenting those metrics, the philosophy behind them and the desired end state. These will be important guides as you plan and communicate the organizational change.

2. Planning, Designing And Communicating

The next step is planning the change. During this step, I highly recommend a white-box approach to your first organizational design. Ignoring the people you currently have, what would the best organizational structure look like to solve the problems you identified in the first steps? How would you design the organization to meet metrics? By starting without the people, you can craft the ideal structure that meets your desired outcome — a good starting point.

From your existing staff, can you plug in the key leadership roles and key individual contributors? Where do you have openings? Do you have staff that can fill those? Are there places you need to reach outside your organization to hire? At this point, you are likely looking at a half or mostly filled-in structure, but you also have some people who don't quite fit. This is where the hard decisions come in.

For each of the sub-structures you have created, what leads to issues? Could a box be filled if you changed the level or reporting lines? What changes would you make to your "ideal" structure to fit more of your existing staff? There are no 100% correct answers at this stage. In the end, you'll be able to fill out most of the org chart without too many compromising decisions, and you'll have some team members who don't have roles. Take the time to evaluate your final chart. Will it accomplish the goals you set earlier in the process? Does it solve the problems you identified? Does it meet the organizational metrics you were looking to achieve? If yes, then you are ready to move on to the next step. If no, then it's back to the drawing board with another approach.

Now that you have designed a new structure, you need to start communicating it. I like to make my talk track consistent for each conversation. I always start with the fact that I am making a change; I explain why and what I am going to be asking of

this person as part of the change. I start with the highest leaders who have roles moving forward and make sure they are on board with the process. I like to personally communicate to the top two levels of the organization, so I have their buy-in and commentary to refine further actions.

3. Ensuring The Change Is Successful

As a leader, you won't be able to walk away; you need to ensure your goal was met. This means working with and empowering your leaders to be successful in their new roles. This will take additional time to help them through the transition and ensure success. I recommend publicly referencing and updating the metrics and measurements with the team to help demonstrate the quick wins and long-term improvements in metrics that you expect to see.

One note: In a sizeable reorganization, it is possible that you will need to make changes 30, 60 or even 90 days out due to a mis-scope of a role or unexpected behavioral change. Be flexible and learn from any mistakes that may have been made. Some decisions may not have been perfect and should be changed. Don't let your design get so stringent you can't make adjustments via learning. Watch the resulting behaviors and metrics to ensure your organizational change is successful.

CONCLUSION

A business structure is the legal framework of a company. It sets out key factors like ownership and profit distribution. The structure of a business should be established before it is registered with local, state or federal governments and should be chosen carefully. It can be costly and restrictive to make changes later.

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