Business Type #1: Sole Proprietorship

Sole proprietorship is a type of business owned by an individual entrepreneur. This person also manages the operations of the business and assumes all the risk and keeps all the profits (or endures its losses).

It is the oldest, most common, and simplest form of business organization. A sole proprietorship can be organized very informally, is not subject to much federal or state regulation, and is relatively simple to manage and control.

The most important characteristic of a sole proprietorship is that the owner is inseparable from the business. Because the entrepreneur is, in a sense, the business, he/she has complete control over operations and is legally responsible for all debts and legal actions taken against the business. The term that describes a sole proprietorship is “unlimited personal liability.”

Another aspect of the inseparable nature of the sole proprietorship is that taxes on the business are determined at the personal income tax rate of the owner. A sole proprietorship does not pay taxes as a business, only the owner needs to pay personal income tax on his annual profits (or declare an income loss).

Sole proprietorships are usually small businesses. About 75 percent of all businesses are sole proprietorship, but they account for only about 6 percent of all revenues taken in by all business types. As small businesses, they are relatively easy to form and operate. However, due to their scale of operation and the fact the owner has unlimited liability, they experience difficulty in raising revenue in the form of loans, and are not permitted to issue stock or bonds. Therefore, they often lack continuity and longevity.

Adapted from http://www.sos.state.ia.us/business/handbookintro.html

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Business Type #2: Partnership

A **partnership** is defined as an association of two or more persons to carry on as co-owners of a business for profit. In other words, if two or more individuals do nothing more than verbally agree to conduct business as owners, a general partnership is formed.

There are also two other types of partnerships: limited and limited liability partnerships.

In a limited partnership, one or more of the partners may be “silent partners.” At least one person must be a general partner. The difference is that the general partner(s) operate the business while the “silent partner(s)” have only a financial interest in the first and are not normally involved in day-to-day operations.

As with sole proprietorships, members of general and limited partnerships have unlimited personal liability. The debts and legal obligations of the first are the personal responsibility of the partners. A partnership is a popular form of business among professional groups (doctors, lawyers, engineering firms). As such, if the personal liability of the firm is shared, a mistake or misdealing of one partner could bring the whole partnership to collapse.

For this reason, partnerships may form as limited liability partnerships (LLP). In this format, the error of one partner does not affect the other partners. If one partner is sued for malpractice, for example, the other partners and the firm are insulated from the legal action.

Although a verbal commitment is sufficient to form a general or limited partnership, it is prudent and for the protection of all involved to have a partnership agreement formally called articles of partnership. State laws also establish rules for common ownership, profit and loss sharing, shared management responsibilities and covenants not to compete with one another. The LLP needs to register with the state where it operates by filing a “statement of qualification.”

Partnerships account for about 7 percent of all businesses in the United States and generate about 10 percent of total income of all business types.

Advantages to partnerships are ease of start up, shared decision making and specialization of tasks. While they are still relatively small businesses and it’s often hard to finance start-up or growth, there is still a larger pool of capital from the assets of each partner. Like sole proprietorships, the business itself is not taxed. Each partner files personal income tax according to their own earnings.

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Business Type #2: Partnership

Disadvantages include the issue of unlimited personal liability (other than an LLP) and the potential for conflict among the partners. The partnership generally has more longevity than a sole proprietorship because more people are involved, but partnerships have less stability than a corporation which is built upon a particular hierarchy, and separation between the business and its owners.

Many of the same types of businesses that operate as sole proprietorships could operate as partnerships if more than one person contributes to the company's assets. The conditions that apply to sole proprietorships are similar to those that describe partnerships.

Stout, C. E. (2012). *Getting better at private practice*. Hoboken, New Jersey: John Wiley & Sons, Inc.

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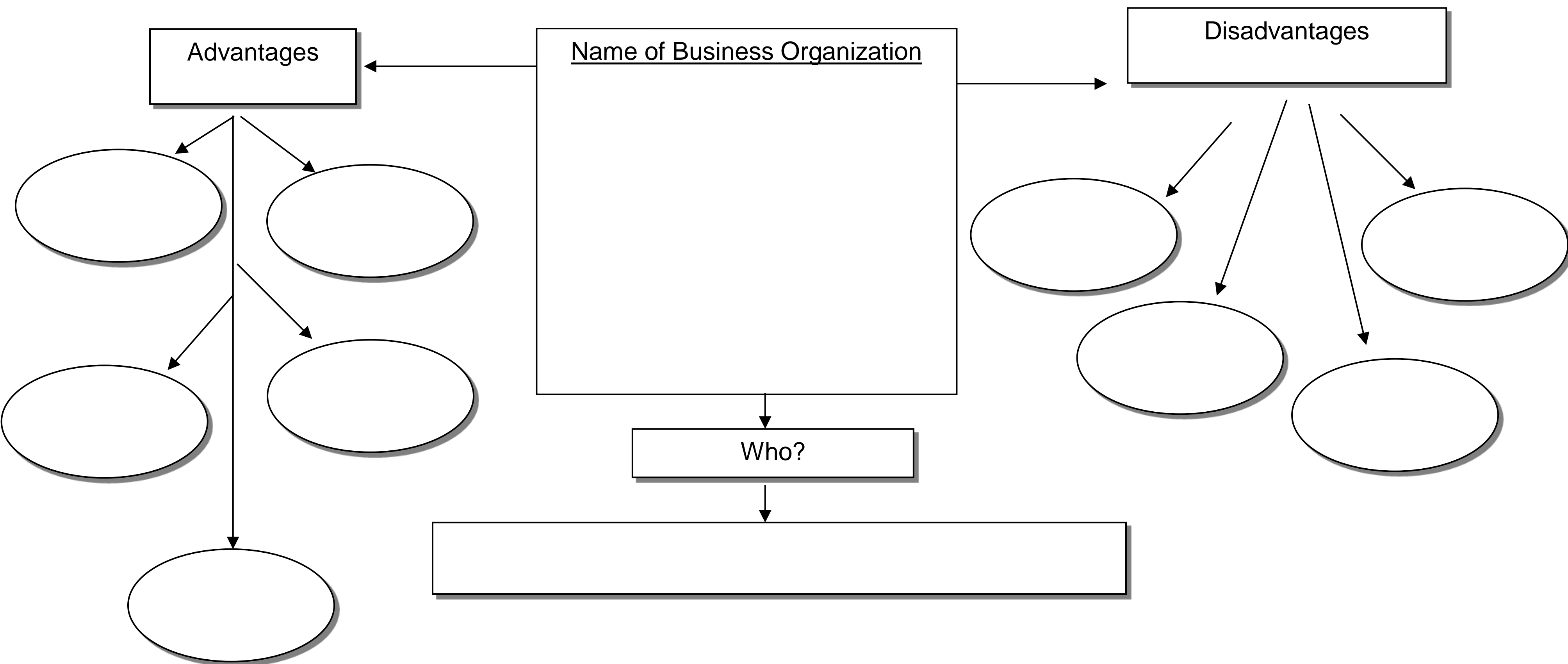
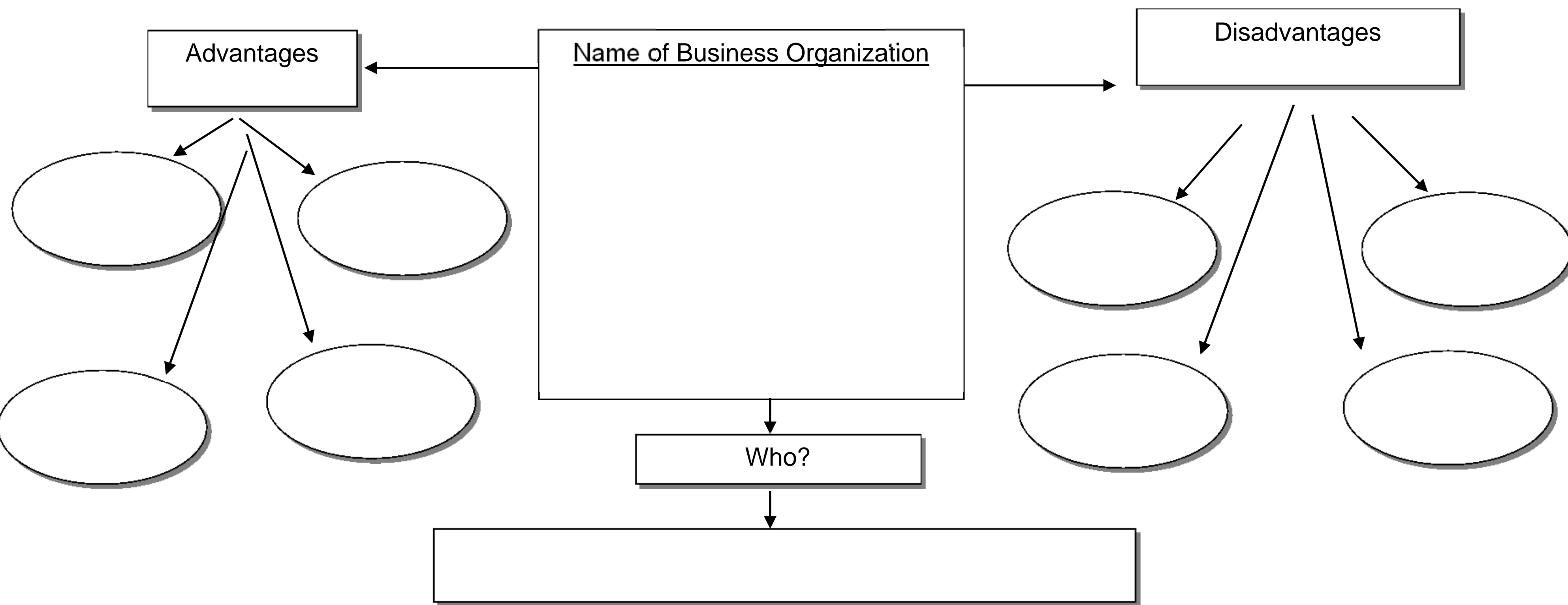
Critical Analysis Organizer
Sole Proprietorship



Critical Analysis Organizer
Partnership



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