PL.2

Owning and Protecting a Business

Structuring a Business

Structure is the way a business is owned, how owners buy in, how profits are shared, how assets are used, and how liabilities are limited and shared.

What does it mean to own a business?

A business owner has invested capital and is entitled to receive a share of profits.

The legal form of ownership will determine how the owner makes their investment of capital and how profits or losses are shared.

Depending on the legal form of ownership, there may be documents that specify how owners are entitled to direct the activities of the business.

Business Entity and Ownership Type

Informally we say that the legal form of a business is the entity type. Formally a business is a separate legal entity if it can sue and be sued separately from its owners. These formal business entities include Limited Partnerships, Limited Liability Companies, and Corporations.

- Sole Proprietorship is the default legal ownership for a single owner.
- General Partnership is the default legal ownership for more than one owner.
- Limited Partnership, Limited Liability Company, and Corporation are forms of legal ownership that must be deliberately created under state law.

What is Capital?

The resources that allow you to operate your business.

- Cash
- Equipment
- Labor
- Land and natural resources
- Knowledge (technical, processes, procedures)

Credit, leases, and labor agreements are all ways to access capital beyond the owners' original contributions of capital.

Capitalizing a Business

Owners capitalize a business by contributing cash, or other assets like land or equipment.

A business plan provides a preliminary assessment of the cash and credit needs of a business.

If a business does not have enough cash, it is “under-capitalized” and may have to take on debt.

At-Risk Capital

Once an owner invests their capital (usually cash and equipment) into a business, that investment is at risk. It may be used to:

- Fund unprofitable activities
- Repay debts that can not be paid from business profits
- Settle legal claims against the business

At-risk capital is also called invested capital because of the risk of loss.

Unlimited Personal Liability

Owners of sole proprietorships and partnerships have unlimited personal liability for debts, fines, penalties and legal judgments against the business.

- May have to use personal savings.
- May have future wages garnished.
- Liability may extend to a spouse’s savings and future earnings.

In a partnership, each partner (and their spouse) is liable for all obligations of the business.

Limited Liability

Business owners may limit their liability to only their at-risk capital contributions by forming a limited partnership, limited liability company, or a corporation.

These entities are formed under state law (or sometimes Tribal or federal law) and may provide liability protection, limiting the owner’s risk to only their invested capital. These entities will never protect an owner from the risk associated with negligence or deliberate bad acts.

Ownership Rights and Obligations

A business plan discusses the owners' rights and obligations including:

- The amount of cash each owner will initially contribute.
- The owners’ rights to direct and manage the business.
- Circumstances under which an owner may be required to contribute additional cash.
- Limitations on how much owners may withdraw.
- Circumstances under which an owner may withdraw capital from the business.
- Restrictions on the sale or transfer of ownership interests.
- How profit and loss will be shared.