



Types of Small Businesses: The Pros and Cons of Various Business Structures & Forms

Description

So youâ??ve finally decided to [start your business](#), and you are eager to bring your vision to life. Before you get started, itâ??s important to know the types of small business available for you.

Understanding your options when it comes to business forms and structures will help you make the best choice. Itâ??ll also help you gather all you need to get your [new business registered](#). The business structure you choose will influence how you can run your business.

It will have a bearing on matters such as [tax](#), costs and statutory requirements. Itâ??s a delicate balancing act choosing your optimal business structure, so before you do, read below to equip yourself to make an informed decision.

[Sole Proprietorship](#)

[Partnership](#)

[Non Profit Organisations](#)

[Private Limited Company](#)

[Public Company](#)

[Personal Service Provider](#)

[Small Business Corporation](#)

Sole Proprietorship

The sole proprietorship is the simplest business structure you can adopt. It's the least costly and takes the least set up time of all the types of small business. It is basically just an extension of the entrepreneur.

Even if the business has employees, the business and the entrepreneur are just one. You can not separate a sole proprietorship from its owner. This means it can't own property and pay taxes or enter into binding contracts.

All this is determined to have been done by the business owner. As soon as you decide to start selling for a profit, you are a sole proprietor. There is no need to register a business to run it as a sole proprietorship. There may be necessary licenses and fees to deal in particular fields, but the business itself need not be registered.

The "sole" in sole proprietorship is very literal. It is set up, owned and run by one person. Once more people are added, it becomes a partnership. A sole proprietorship is a good business structure to start with, but you should aim to move from it as soon as possible.

It carries a lot of advantages in the early stages, but these soon become drawbacks as you grow. Unless you don't intend to grow, which is un-advisable, this should just be a passing phase.

Benefits and Drawbacks of Sole Proprietorships

The biggest advantage of a sole proprietorship is the ease of setting up. You can set up and start trading immediately, with little time and cost involved. No legal formalities are involved, except where there could be licenses and permits required.

Sole proprietorships also retain a great deal of control. All decisions and full ownership remain in the hands of the founder. The business is taxed in the hands of the owner, not separately.

Because individuals are taxed on a sliding scale basis, at low incomes, this tax is significantly lower than corporate tax. Survivalist entrepreneurs may even manage to not pay tax at all.

This, however, can quickly become a drawback. While the corporate tax rate is 28%, individual tax rates may go up to 45%. If your business qualifies as a Small Business Corporation or for Turnover Tax, this rate could even be lower.

But the biggest drawback is perhaps an unlimited liability. The financial liabilities, as well as decisions of the business, extend to the owner. She will be called upon to pay them and take responsibility for them if the business fails to. There is also little to no continuity in a sole proprietorship.

Usually, when the founder passes on, the business ends with them. Capital raising is also a challenge, as these tend to be riskier forms of business. Their dependence on the skills and knowledge of one person only adds to this riskiness.

Partnership

A partnership is an extension of the sole proprietorship. It occurs when more than person go into business together but do not register anything. This number is limited to twenty people. Like sole proprietorships, partnerships are not separate legal entities from the partners.

As a result of involving more than one person, a little more admin is involved in a partnership. The interests of the partners need to be protected, and as a result, a partnership agreement is drawn. It outlines the basic guidelines of how the partners will relate and run the business.

Among the provisions of a partnership are guidelines pertaining to:

- The contribution of capital and assets into the partnership by each partner
- The share of ownership of each partner
- Distribution of remuneration and profit among the partners
- Rules for retirement, sell of a partner's share or dissolution of the partnership

The partners in a partnership can be ordinary, silent, or anonymous. Ordinary partners are the most common, shouldering the responsibilities of running the partnership. They are at the front, representing the partnership with external shareholders.

Anonymous partners only deal with other partners. They are not liable to external partners but are liable to their fellow partners for their share of the business. Silent partners only contribute capital into the business. They have no interest in the day to day running and decision making.

Benefits and Drawbacks of Partnerships

Partnerships are relatively easy to set up and run since they do not need to be registered. It is a good idea, however, for the partners to invest in a professional to draw up their agreement. They also retain ownership and responsibility with the partners like sole proprietorships. Partnerships do carry the advantage of drawing on the skills and knowledge of more than one person. They also enjoy the advantage of being able to draw on a wider source of capital. While these advantages are over sole proprietorships, they are still limited compared to other types of small business. While it may be an advantage to have more experience to draw on for decisions, an added disadvantage is that every partner is responsible for every partner's decision. Partners are taxed as individuals and will enjoy

the same benefits while enduring the same drawbacks of the sliding system as sole proprietors. It can be difficult to maintain harmony in a partnership. Issues may arise when it comes to making contributions and responsibilities. This could cause rifts among partners, particularly regards the sharing of profits and ownership. It's advisable for partners to revise these regularly to reflect changing circumstances.

Non Profit Organisations

While you might not think of your non-profit organisation as a business, it is, and the sooner you think of it that way, the better it'll fare. You have a target market to serve, you have suppliers, you need investors, you have goals and stakeholders want performance.

That is a recipe for a business. Simply put, charity thought of in any other way is simply not sustainable. We even explored how businesses can [pursue charity without forsaking the all important profit](#).

And the first step to properly running your not for profit business as a proper business is to register it. Your charity may be a company, trust, or any form discussed here, but registered as designated for the public good.

Non-profit organisation is not to say your organisation can't make a profit, it's that it's not a profit in the traditional sense. Unlike traditional companies, trusts or any business form, an NPO can't distribute any excess of income over expenses.

This excess, known as a surplus, is perpetually reinvested in the expense of the NPO. NPOs can be;

- Non-governmental organisations (NGOs)
- Community-based organisations (CBOs)
- Faith-based organisations (FBOs)
- Section 21 Companies
- Any other voluntary association that is not for profit.

Section 21 Companies

A section 21 company is a company created primarily to serve the community, as opposed to profit. So while any company may be registered as a non-profit, a section 21 is registered as a non-profit from the onset with [CIPC](#).

Unlike a private company, a non-profit company must have at least three directors. It is not necessary however to have anyone who carries out the activities of the non-profit, also known as members.

To receive national grants, additional registration is required with the [Department of Social Development](#). Your NPO needs to set out at least one key objective which is either a public benefit object or an object relating to cultural or social activities, or communal or group interests.

Should you choose to register your business as an NPO, it's important to know it may not be converted into a for-profit company at a later stage.

Benefits and Drawbacks of NPOs

The only drawback of an NPO is that it can not be "owned". You can be a director in it, but it cannot belong to any person/s. For every other business form, certain criteria can be met that entitles you to ownership.

This ownership is to varying degrees, very high in sole proprietorships to partnerships to private companies to public companies. NPOs cannot be owned at all, and by extension can not distribute their income.

The advantage of being a registered NPO is that it legitimizes your cause. It immediately communicates your dedication to your cause and may encourage more people to participate. Additional benefits may accrue by way of tax incentives, but these are not automatic.

Donations to recognised charities are tax deductible for businesses and individuals. Because of this, getting your NPO properly registered will help convince more donors to help you out more.

Private Limited Company

A private company is a registered business that forms a separate legal entity from its owners. It is a statutory person, meaning it can contract, own property and pay taxes in its own right.

Its founders have limited liability, limiting their responsibility for the financial obligations of the business. This is unless it can be proven that the directors knowingly acted negligently in the running of the business.

In any other instance, creditors have no recourse against the company's directors for amounts owed. Ownership in a private company is determined by the number of shares held in the business.

It's necessary for a private business to have at least one director and incorporator, who may or may not own shares in the business. 100% foreign-owned private companies still need to have one local

officer. The number of shareholders for a private company is limited to fifty.

Private companies require you to make a formal registration with the CIPC before you can get started. Additional requirements, e.g. payment of annual returns, may be necessary to stay registered. Private companies can enjoy a separation of ownership and management.

Benefits and Drawbacks of Private Companies

Private companies enjoy a flat tax rate of 28%, which is significantly lower than individuals at 45% at high income. This separation also extends to financial liabilities and may offer owners some protection from the business's debts.

Private companies allow foreigners and foreign entities to own shares in the business, even up to 100%. This makes it easier to get international investment for your business. The share system also makes it easy to transfer ownership in a business.

Ownership in private companies can simply be transferred by the sale of shares. The company should be careful when selling shares to people who are not already shareholders. When selling to the general public, there are regulations that apply.

Private companies have an advantage over public companies in that while they are required to maintain financial statements, they are not required to file them publicly. This goes for other operations and activities as well.

Private and public companies enjoy an unlimited lifespan. Where additional shareholders can be found, the business can continue even if any of the founders dies or retires.

There is however a cost involved in setting up a private company as well as regulations that apply. There may also be an added cost in auditing, as private companies may need to have their financial statements audited.

The limitation of liability makes private companies riskier than individuals for creditors and lenders. Because of this, it may be tougher to access loans from financial institutions. Generally though, because they are better structured and run, private companies access investors easier.

Private companies have an advantage over sole proprietorships and public companies because of their adaptability to small and large businesses. In terms of adaptability, private companies are the most applicable business structure.

Public Company

It's important to say, there are very few instances where a public limited company is ideal for a small business. The advantages will often pale to the drawbacks when you are starting out. Additionally, the regulations for starting a public company may be beyond small businesses, removing the element of choice.

It's better utilised at later stages as the business grows. The easiest way to tell if a company is a public company is its ability to sell shares, usually on the stock exchange. Public companies are listed and the public can buy available shares from the company via this exchange.

Because of this, the number of shareholders is limited by the number of authorized shares the business has.

The minimum number of shareholders is, however, regulated at a minimum of seven, for incorporation and continued existence. Directors, on the other hand, can come down to three minimum. Public companies can be identified as having Ltd and limited at the end of their names.

Benefits and Drawbacks of Public Companies

A public company carries similar advantages to a private company including separate legal status, flexibility, continuity while having drawbacks like increased statutory requirements.

But its greatest advantage is perhaps its ability to raise capital from the public as a whole. Its very structure extends your pull of investors to virtually the adult population of the world as well as certain institutions.

Capital raising for a public company is truly unlimited, some even raise billions without the performance to back it. Because of this, its major drawback is the high regulation involved in forming a public company.

It can be time-consuming, costly, and as mentioned, many businesses may not qualify. The legal requirements do not end in the incorporation phase either. Public companies are expected to maintain and make public a lot of legal documents, among other daily requirements.

The biggest disadvantage of a public company is a loss of control. Each ordinary shareholder gets a say in the running of the company proportional to their shareholding, so decisions will be taken away from you.

Moreover, because shares are traded publicly, it's impossible to control who has a say in the decision and how much that say carries. Even the destiny of the business itself may be beyond your control. Factors such as speculation and market factors may adversely affect the value of your business without much underlying cause.

Personal Liability Company

One of the defining characteristics of a company is the limitation of liability it's founders enjoy. A personal liability company does away with this, with its directors jointly and severally liable for the company's financial obligations and decisions.

This means that if the company fails to meet them, payment can be demanded from these directors. As with a private company, Personal Liability Companies are considered separate entities from their directors. Additionally, these financial obligations do not extend to the shareholders of the company.

All in all, this liability is limited to those contractual debts and decisions entered into during a director's tenure. • Contractual obligations is used in legislature to limit directors' obligations to the company's ordinary financial, commercial and trade commitments.

This right of resource for financial obligations is available to a Personal Liability Company's trade partners. The company itself cannot claim debts it paid on its own behalf from its directors.

A personal liability company can be identified as ending with inc or incorporated in its title. A PLC is mostly suited for professionals who want to register a company as opposed to running as a sole proprietorship or partnership. These businesses mostly lend themselves to associate type businesses like lawyers, accountants, auditors or engineers.

Benefits and Drawbacks of PLCs

The limitation of liability may make it easier to attract shareholders and raise capital, which is a definite plus. Since, however, this limitation of liability only applies to shareholders, getting partners to help you direct the business may be a struggle.

Since directors are held liable for the actions of the PLC as a whole, you may find yourself equally liable for other director's actions and decisions. This increases the need for good governance, which may be time-consuming and costly.

It does, however, present the advantage of better decision making from directors. At the very least, it will inspire you to choose wisely who to go into business with. Additional pros and cons are similar to those of a private limited company.

These include separate legal status, flexibility, continuity while having drawbacks like increased statutory requirements.

An immediately identifiable advantage of a PLC over a private company is the ability to enjoy benefits like flexibility, legal status and perpetuity while retaining liability for the company's obligations, which may be useful for associations of professional persons.

Personal Service Providers

A personal service provider derives income mainly as the reward for an individual's skills and efforts. To qualify as a PSP, the company must mainly be represented by an individual who provides services directly to another.

In such an instance, this individual would have the characteristics of an employee, though representing a company. While being a company, a personal service provider is subject to the withholding of employee's tax where their revenue is earned.

A company or trust is a personal service provider if it meets the following criteria;

1. Amounts paid to the company include remuneration.
2. The services are rendered by a connected person to that company
3. The company did not employ 3 or more permanent employees directly related to its services in a given period. An auxiliary staff that does not enable the delivery of the service does not count in this determination. These employees may not be shareholders of the company or beneficiaries of the trust.
4. Whoever delivered the service would have otherwise been considered an employee had the service not been provided via the company.
5. The service is rendered mainly at the premises of the client. There's also a need to determine if the client exercises supervision over the provision of the service.
6. 80% of the company's income is derived from one client. This 80% refers to income from services rendered in accordance with the company's business. Ancillary income does not count in this determination.
7. The company meets all these criteria in any financial year/ year of assessment.

There are no real benefits to mention in being a PSP. The difference to any company is that tax is determined at 33% in the case of a company and 40% in the case of a trust and withheld by the

business paying you. Furthermore, you lose the ability to claim some of the expenses companies have the ability to.

Your claims as a PSP are limited to remuneration to employees, contributions to pension, provident and benefit funds, legal expenses, bad debts, expenses in respect of premises, finance charges, insurance, repairs, fuel and maintenance in respect of assets used wholly and exclusively for trade and any amount previously included in taxable income and subsequently refunded by the recipient.

Small Business Corporation (SBC)

A Small Business Corporation is not a distinct type of company in its own right, but rather a criterion set by SARS. Businesses identified as an SBC enjoy a few tax benefits aimed at making them more viable and sustainable. A close corporation, co-operative, private company that is not a personal liability company is considered an SBC if;

1. All the shares in that company for the year were held by natural persons, e.g. not by other companies.
2. These natural persons do not hold shares in any other company.
3. The business made gross income/ revenue not exceeding R20 million.
4. 20% or less of this income is not generated from investments or personal services. Personal services include accounting, actuarial science, architecture, auctioneering, auditing, broadcasting, consulting, draftsmanship, education, engineering, financial service broking, health, information technology, journalism, law, management, real estate broking, research, sport, surveying, translation, valuation or veterinary science, if the business does not throughout the year employ three or more full-time employees (other than any employee who is a holder of a share in the company or a member of the co-operative or close corporation, as the case may be, or who is a connected person in relation to a holder of a share in the company or a member), who are on a full-time basis engaged in the business of that company, co-operative or close corporation of rendering that service. • A personal service derives income mainly as the reward for an individual's skills and efforts.
5. All these criteria are met within the business's financial year/ year of assessment.

You can test if your business is an SBC on [Tax Tim](#), or follow the flowchart below.

Benefits and Drawbacks of SBCs

Small Business Corporations enjoy reduced [tax](#) benefits. For the current financial year, SBC tax rates are as follows:

Taxable income (R)	Rate of tax (R)
0 – 78 750	0%
78 151 – 365 000	7% of taxable income above 78 150
365 001 – 550 000	20 080 + 21% of taxable income above 365 000
550 001 and above	58 930 + 28% of taxable income above 550 000

In addition, SBCs get to claim accelerated [depreciation](#). When this depreciation is written off as an expense, it will further reduce profits and the tax expense of the business.

Accelerated depreciation rates are 50%, 30% and 20% in consecutive years, which are significantly higher than the [SARS prescribed wear and tear allowance](#). If your business loses SBC status in subsequent years, you can continue to enjoy this accelerated depreciation.

However, businesses that gain SBC status having already started writing off depreciation at the normal wear and tear allowance may not move to the accelerated depreciation system.

Conclusion

Before you get started, understand the legal requirements as well as the tax implications of your chosen business structure. Different small business types will have varied times to set up, so this should be something to consider as well.

Just remember you can switch structures as others become more suited, so choose one that best suits your needs at this time. If you have been running your business in any form for a while, maybe it's time to revise its structure.

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1. Business Insights
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2. Business Management
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