# Business Formations

Multiple factors can influence your access to financing for your business. The legal structure of your company is one such factor. Before you commence your capital raising efforts, it is helpful to understand the role it plays in the process.

## Sole Proprietorships

A sole proprietorship is the least complicated entity to establish. For legal and tax purposes, the business owner and the business, are one and the same. The business's income and assets all belong to the owner, and he or she, is solely responsible for any debts incurred by the business.

With regard to financing, operating as a sole proprietorship narrows your options to a degree. Lenders will use your personal credit profile to determine whether you qualify for loans or lines of credit, for the business. To that effect, you will need to sign a personal guarantee, commit collateral, or do both, to be approved for a loan.

Qualifying for a business credit card may be easier if you have a strong personal credit score. Again, however, you will likely be required to sign a personal guarantee. This is a legally binding agreement that allows the bank to hold you personally responsible, if you default on the account.

## Partnerships

A partnership is centered on two or more individuals who share ownership of the business. All partners share in the profits and losses, as well as the management of the business. Compared to sole proprietorships, partnerships have more flexibility with financing. It may be easier, for example, to qualify for a loan or line of credit, using the business's credit profile. Lenders will still review the personal credit of each partner. A history of delinquencies or charge offs on one person's profile could consequently sink the application.

Equity financing is an alternate route partnerships can pursue. It can be done in two ways. The first is to have existing partners invest more money into the business, in exchange for a larger ownership stake. Otherwise, the company can bring new partners on board, who would also receive shares in the business, in proportion to the capital they invest.

When taking on new partners, it's important to decide whether they'll play an active role in the management of the business, or operate as silent partners. If it's the former, weigh the impact on business operations, against the opportunities created by the access to new capital.

Silent partners will likely want to insulate themselves from personal liability for business debts. In that case, the business can be organized as a Limited Partnership. Those partners actively involved in the management of the company will bear the liability for business debt.

## Corporations

Incorporating creates an entirely separate business entity, which offers the founder(s) and management team, certain personal protections against liability. Apart from that benefit, operating as a corporation opens the door to a broader range of financing options.

For example, it is possible to obtain a corporate credit card versus a small business card. Corporate cards may offer greater spending power, and approval is based on the business's credit history, not your personal history. A corporate card may be the better option if you run a larger business with multiple employees.

Corporations also have the benefit of being able to seek funding through venture capital funds or angel investors. These are private investors who provide money to corporations in the seed or growth stages. Using venture capital investments to fund your business has its advantages, since you're not obligated to pay the investor back if you're unable to make the venture a success. If the business does take off though, investors will expect a commensurate return.

## Limited Liability Company

A limited liability company combines structural elements of a corporation with the tax benefits of a partnership. You can operate as an LLC alone, or in conjunction with other owners. All LLC owners are protected from personal liability from business debt, unless they personally guarantee debt on which the LLC defaults. Financing options available to sole proprietorships and partnerships, are also viable for LLCs.

Unlike corporations, however, venture capital may not be an option for LLCs. An LLC, like a sole proprietorship or a partnership, is a "pass-through" entity, i.e. an entity not subject to income tax. A VC fund would be subject to taxation on the LLC's income, even if it receives no cash distributions. Some VC funds prohibit investments in LLCs, due to this tax implication.

**More from the Resource Center: Debt vs. Equity Financing Explained**