CORPORATE STRUCTURES AND OWNERSHIP

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BUSINESS STRUCTURES

Business Structure→ How a business is set up from a legal and organizational standpoint.

Key aspects within Business Structure Analysis:

- **Legal Relationship:** Legal relationship between the owners of the business and the business itself.
- **Owner-Operator Relationship:** Are the owners of the business the ones who manage the firm? If not, what is the nature of the relationship between the owners and the managers of the business.
- **Business Liability:** Extent of the responsibility of the owners to liabilities of the business (debt or actions), and whether it is limited liability or unlimited.
- **Taxation:** Tax treatment of the results obtained by the firm.

Importance of understanding the differences in the four abovementioned aspects for the 4 main Business Structures:

1. Sole Proprietorship.
2. General Partnership.
3. Limited Partnership.
4. Corporations.

SOLE PROPIETORSHIP

1. No legal identity. The business is an extension of the owner.
2. Business Operated by the Owner.
3. The owner retains all the profits but assumes all the liabilities (unlimited responsibility).
4. Profits are taxed as personal income of the owner.
5. High simplicity and flexibility at an operational level.
6. Informal sources of financing.
7. Significant limiting factors in terms of growth (risk and financing ability)

GENERAL PARTNERSHIP

1. Still No legal identity. The partnership agreement specifies ownership (each partner share of profits and its responsibilities (operational and profit and loss sharing)
2. Business Operated by the Partners.
3. Partners have unlimited responsibility and share all the liabilities and risk of the business (and profits too)
4. Returns are taxed at a personal level.
5. Still Significant limiting factors in terms of growth (risk appetite of the partners and financing resources)

LIMITED PARTNERSHIP

1. Still No legal identity. The partnership agreement specifies ownership (each partner share of profits and its responsibilities (operational and profit and loss sharing)

2. General Partners Operate the business and have unlimited liability.

3. Limited Partners have limited liability. However, they don't have control over the business operations.

4. Returns are shared among partners (the distribution of profits among partners is stipulated in the partnership agreement) and partners are taxed at a personal level.

5. Still Significant limiting factors in terms of growth
   1. Risk appetite of GPs
   2. GP & LP financial capabilities
   3. GPs ability to run the business.

CORPORATION (aka LLC)

1. Legal Entity separate from its owners and from the management team.
2. All shareholders have limited liability.
3. The corporation can distribute profits to its shareholders but is not required to do so.
4. Access to capital is significantly increased in this legal form (both in terms of debt and equity)
5. Owners and Managers and separated, with the owners having the right to appoint a board of directors that hires and monitors the Management Team.
6. Types of Corporations
    1. For-Profit vs Not-For-Profit
    2. Public vs Private
7. Other considerations
    1. Double Taxation (CIT at a firm level and Personal Income taxes to Dividends)

Compare public and private companies

1. Public Company→ Shares are listed in an organized Stock Exchange.

2. A private company can become public via an IPO.
    1. Public companies have much more significant requirements than private, in terms of reporting obligations (quarterly reporting, annual audited financial statements, disclosure of relevant matters, etc)

3. A private placement is a way for private companies to raise capital.
    - Shares are sold to accredited investors (HNW individuals and/or institutional investors)
    - A PPR (private placement memorandum) is prepared and distributed to potential investors.
    - The PPR includes financial and business info about the private firm, but disclosure is much less strict than in a public company or an IPO.

4. Investors in Private Companies tend to have a longer time horizons.
    1. It is much harder to sell a share in a private firm
    2. They tend to wait for selling when an IPO or an Acquisition takes place.
    3. Potential returns can be higher than returns in public stock investing.

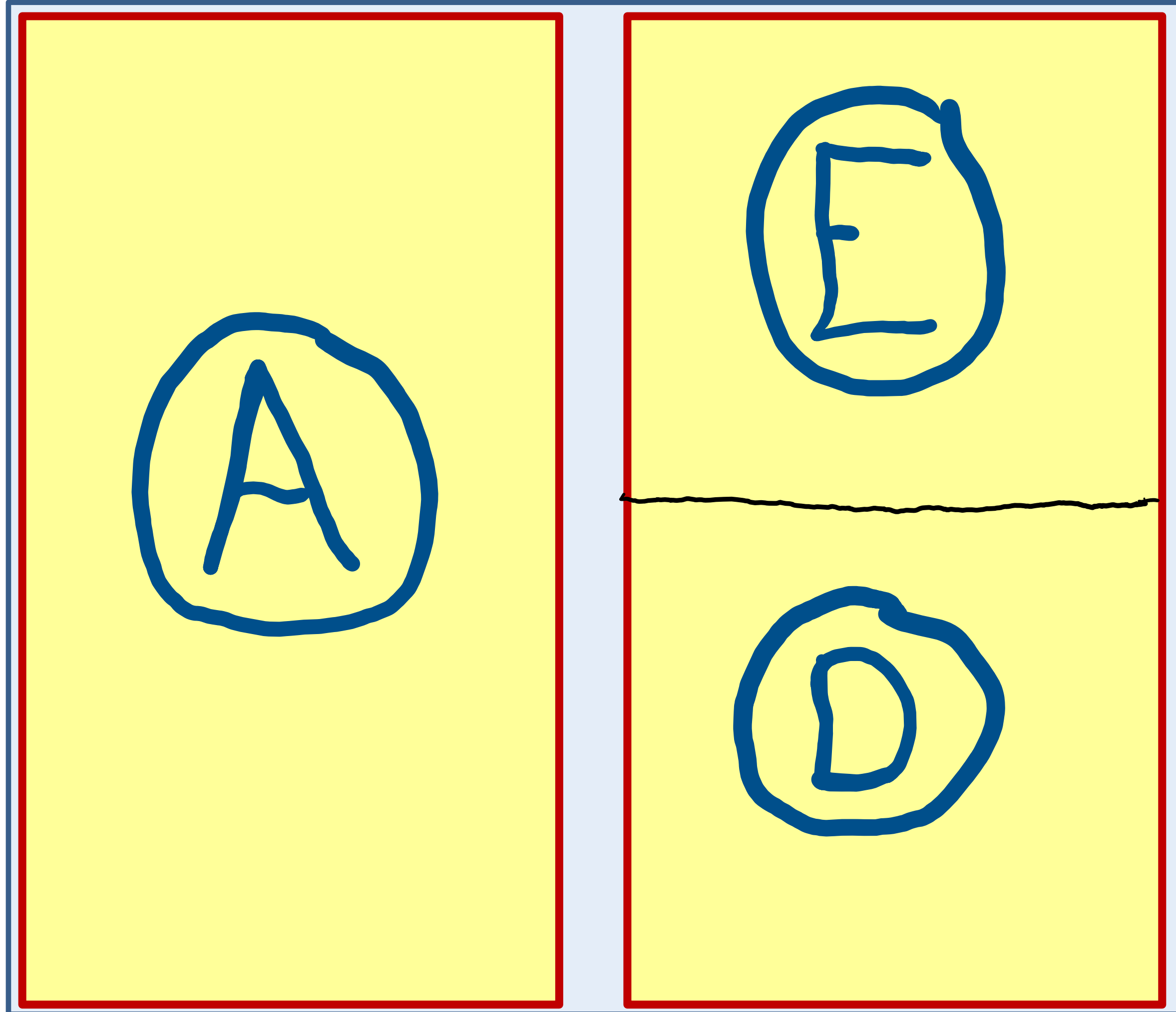
ADDITIONAL WAYS FOR A PRIVATE COMPANY TO BECOME PUBLIC.

1. Direct Listing → The stock exchanges agrees to list the shares of the private firm.
   - As opposed to an IPO, no capital is raised nor sold.
   - Much quicker
   - Lower fees as no need for an underwriter and advisor for the IPO.

2. SPAC (Special Purpose Acquisition Company)→ A firm that is set up to acquire a private company in the future. Shares are listed in an organized Stock Exchange.
   - The SPAC raises the capital needed for the acquisition in an IPO.
   - The capital is deposited into a trust until the acquisition is performed.
   - The target company may or may not be identified at the time of the IPO (that is way this firms are also known as black check companies).

A PUBLIC COMPANY MAY BECOME A PRIVATE COMPANY

- Go private LBO.
- MBO.



OWNERS		LENDERS
DESPUÉS	Orden de Prelación	ANTES
NO	Previsibilidad Cash Flows	SÍ
SÍ	Participación Éxito Futuro	NO
MAYOR	Participación Fracaso Futuro	MENOR

LENDERS vs OWNERS

- Lenders have a contractual / legal claim to interest and principal.
- Owners have a residual claim.
- Therefore, lenders have priority of claims.

Lenders and borrowers can both lose all their initial investment. But no loss beyond their investment.

However, upside is pretty different. The upside for the lender is limited to the agreed upon interest and principal. Unlike lenders, owners have unlimited upside.

CONFLICST OF INTEREST

- Because of the abovementioned differences, conflicts may arise between the two.
- Lenders interests:
  - Capacity of the firm to repay principal and pay interest.
  - No significant interest in growth.
- Others (dividends, share repurchases, share increases, covenants)