SELECTING A LEGAL STRUCTURE: REVISITING THE STRATEGIC ISSUES AND VIEWS OF SMALL AND MICRO BUSINESS OWNERS

Giles T. Hertz
University of Tampa
ghertz@ut.edu

Fred Beasley
University of South Carolina Beaufort
fbeasley@uscb.edu

Rebecca J. White
University of Tampa
rwhite@ut.edu

ABSTRACT

Entrepreneurs often make decisions about the legal structure of their new business without fully considering the effect of the decision on other strategically important concerns. The question of whether the new venture should be formed as a sole proprietorship, partnership, corporation, limited liability company or one of several other legal forms is a complex one. To effectively answer that question requires the founder to consider the advantages and disadvantages of each, and how the choice will affect four primary areas of concern: startup costs; the firm’s exposure to legal liability; tax position; and finance options. This research addresses a gap in the literature and investigates the decision-making process of 513 founders of small and micro businesses in selecting a legal structure and clarifies other related concerns such as the source of entity structure advice, the factors influencing entity selection and the resultant confidence and satisfaction with the chosen legal structure. Findings suggest that small business owners who obtain counsel from accountants and/or attorneys are more likely to consider the full spectrum of implications of legal entity type and are generally more satisfied that their choice will positively affect firm profitability.

Keywords: legal entity selection, legal structure, business formation, legal liability, business risk, insurance
INTRODUCTION

The study of legal issues and their effect on the development of new ventures has received insufficient consideration in the existing literature (Malach et al., 2006). In their study of legal issues and new venture formation, Malach et al. (2006) found that the number one legal issue for early stage entrepreneurs is choosing the legal entity type. Choice of legal entity as a “strategic” decision for an entrepreneur is not an entirely new notion, however. More than two decades ago, Khandekar and Young (1985) argued that strategic planning is important early in the new venture creation process. The authors suggested these early strategic decisions are often complex ones that require the ability to work effectively with outside experts and, in fact, they suggested that the first strategic decision the founder of a new business venture often makes is the selection of the most appropriate legal structure for the company. At the same time, Ireland et al. (1985) reported findings on the use of, and satisfaction with, external legal services by entrepreneurs in Oklahoma as compared to earlier findings by Davies (1979) among entrepreneurs located in Connecticut. Collectively, these studies suggested patterns of interactions between businesses and their legal advisors and provided interesting findings for entrepreneurs regarding how to effectively seek advice and make strategic decisions about legal entity choice.

More recently, Bagley (2008) argued that “legal astuteness,” which she defines as “the ability of a top TMT [top management team] to communicate effectively with counsel and to work together to solve complex problems (p. 378),” is a valuable resource that can ultimately be translated into increased profitability and competitiveness for an individual firm. In her discussion of legal astuteness, she specifically identifies choice of legal entity as an example of a “legal tool” that can be used to increase value and manage risks of a firm.

While the nomenclature for the concept of “legal form” may vary (e.g. entity form, entity type, legal structure or legal format), the foundation of the inquiry remains fixed in that the founder must choose between one of several legal forms for their business. In recent years the variety of legal forms of doing business has increased. Some of these relatively new entity types include limited liability partnerships, family limited liability partnerships and, limited liability limited partnerships. Because many of these new entity types have not yet been adopted in a majority of the states, this paper focuses on the most common, and most utilized, legal forms of doing business. These include sole proprietorships, partnerships, limited liability companies and corporations, which, due to their distinct characteristics, include both traditional C-corporations and S-corporations.

This research seeks to build upon previous studies to understand the current state of decision making processes of small business (SB) owners when choosing a legal form for doing business. In particular, the paper examines questions associated with the impact of professional advice on the factors considered by SB owners and their resulting satisfaction in their entity choice.
EXISTING RESEARCH ON LEGAL ENTITIES AND SMALL BUSINESSES

Choice of Legal Entity as a Strategic Decision

The legal form selected has both short and long term strategic implications in certain critical areas of a business (Bagley, 2008; Hertz, 2006; Byrd and Richey, 1998; Scholes and Wolfson, 1992). A number of studies have outlined and analyzed various issues that should affect the choice of legal entity. Karl (1999), in a question and answer format, describes the advantages and disadvantages of different types of business entities as they relate to issues such as legal liability, the business entity’s purpose, income splitting, and taxation. Porcaro (2007) categorizes the important issues in the choice of legal entity as capitalization, compensation, profit and loss allocation, and the tax-treatment of distributions of property or cash. For Sumutka (1997), the important areas affecting the choice of business entity include: 1) ownership restrictions (number and type of owners); 2) management control; 3) limited liability; 4) reliability of business form; 5) company-paid fringe benefits; 6) taxation of profits and losses; and 7) formation costs. Opiela (2004) speaks of the need for SB owners to look at their businesses in the context of their overall lives and “because there are no easy answers when it comes to entity selection, planners advocate a meeting of the minds with the client’s CPA and attorney.”

Despite the importance of the business entity decision, many new and existing business owners fail to appreciate the impact that this choice will have on their businesses, and their abilities to strategically plan for the future (Khandarkar and Young, 1985). While the majority of business owners seek assistance from such qualified sources as lawyers and accountants, some seek out only the advice of friends or self-help books to guide them through this early stage process. Unfortunately, an ill-informed decision on entity form made early in the start-up process may lead to a host of problems later on. For example, an owner seeking to change from one entity type to another to improve an unfavorable tax position may incur substantial tax liabilities during the reorganization process, in addition to the cost of conversion itself (Smith et al, 2007; Cash et al, 2005). This unfortunate result could have been avoided with a better understanding of the tax ramifications of each entity type during the initial decision making process.

Legal Issues and Business Ownership

Research on the legal issues faced by SB owners has focused on a wide variety of legal concerns from pre-employment risks and liability (Fenton and Lawrimore, 1992) and government regulations with which they must comply (Ramsey and Williams, 1996) to the misconduct of employees or owners (e.g. sexual harassment) (Robinson et al, 1998). There have also been studies that have examined industry specific legal issues such as those unique to healthcare (Teske, 1995) or technology (Mauer, 1993). Finally, research has also examined legal issues as they relate to specific business decisions or functions such as those related to international trade (Pathak, 1994) or buying or selling a business (Bauer, 1993).
In spite of these efforts, researchers have expressed concern that many SB owners are generally not aware of the potential legal issues they may face (Brown, Colborne and McMullan, 1988). In an attempt to help SB owners better understand the role of legal issues affecting small businesses, some research has attempted to offer a taxonomy of the legal issues faced by SB owners (Jones, 1997; Mellor and Lee, 2001). Others have expanded this effort in an attempt to determine which legal issues are most frequently encountered by SB owners (Thomas and Usry, 1991; Heriot and Huneycutt, 2001). One such recent study, conducted with 3,000 small business client cases at a university legal clinic, examined nine primary legal issues of concern to early stage SB owners (Malach et al, 2006). The nine concerns included: business format (choice of entity type), intellectual property, liability, regulation, contracts, tax, employment, financing and real property. An analysis of the cases revealed that the decision regarding business format or legal entity type was the dominant legal issue of concern in these cases. Nearly 60% of the clients were facing this legal issue when they visited the legal clinic.

The costs associated with changing entity forms at a later date can be quite high. Thus, it is important for SB owners to fully weigh their entity selection options early on and make a choice that provides them with maximum flexibility and takes into account the strategic goals for long term growth of their businesses. In spite of the importance of this decision, researchers have not examined this decision making process among SB owners.

HYPOTHESES

The importance of the role of professional advice in legal decisions (Bagley, 2008; Ireland et al, 1985) as well as the strategic nature of this decision (Khandekar & Young, 1985) has been cited in the literature. According to Khandekar and Young (1985), legal entity choice is a complex decision that impacts small businesses with respect to resources, interactions with their environment and the firm’s ability to achieve its goals. There are at least four criteria a SB owner should evaluate with respect to legal structure: cost and ease of formation, tax implications, impact on financing and liability protection (Hertz, 2006; Scholes and Wolfson, 1992).

Choice of legal structure is often the first strategic decision made by a SB owner (Khandekar & Young, 1985), and since many firms must bootstrap finances during this time, cost and ease of formation will be the primary, and perhaps only, factor considered unless the SB owner seeks professional advice and thus gains an understanding of the many facets of this decision. Thus, we expect that SB owners who seek advice from either an accountant or an attorney (or both) are less likely to be concerned about cost and more likely to consider the full breadth of factors (liability, tax implications and impact on financing) than if they do not seek such advice. Moreover, we expect that those who do not seek the advice of accountants and attorneys do so because their primary decision factor in entity choice is cost and ease of formation. Thus, we suggest the following hypotheses:

H1a: SB owners who seek counsel from either an accountant or an attorney (or both) when selecting a legal entity for
their businesses are more likely to consider liability protection as a factor when selecting entity type than SB owners who do not seek the advice of an accountant and attorney.

**H1b:** SB owners who seek counsel from either an accountant or an attorney (or both) when selecting a legal entity for their businesses are more likely to consider tax implications as a factor when selecting entity type than SB owners who do not seek the advice of an accountant and attorney.

**H1c:** SB owners who seek counsel from either an accountant or an attorney (or both) when selecting a legal entity for their businesses are more likely to consider financing as a factor when selecting entity type than SB owners who do not seek the advice of an accountant and attorney.

**H1d:** SB owners who seek counsel from either an accountant or an attorney (or both) when selecting a legal entity for their businesses are less likely to consider cost of formation as a factor when selecting entity type than SB owners who do not seek the advice of an accountant and attorney.

Ireland et al (1985) examined the degree of satisfaction with, and trust in, legal advice among SB owners. In their study of SB firms in Connecticut and Oklahoma they found a high level of confidence and trust in lawyers. In addition, Bagley (2008) argued that business leaders who recognize the importance of legal issues to the success of their business will deal more “effectively with the uncertainties inherent” in decisions that require the exercise of informed judgment. Thus, we expect that this confidence will be transferred to the decisions made as a result of the advice. Therefore, we suggest that SB owners seeking the counsel of an attorney or accountant (or both) when making decisions about legal structure will be more confident that their entity decisions will provide the personal and firm liability protection that they need. Moreover, we expect SB owners who seek advice from accountants and/or attorneys when selecting an entity type will be more confident that the entity type selected will protect their personal assets if the business is sued, are more satisfied with their entity choice overall, will be less likely to change entity form and will be more satisfied that the entity type they have chosen will enhance profitability. Thus, we suggest the following hypotheses:

**H2a:** SB owners who seek counsel from either an accountant or an attorney (or both) when selecting a legal entity for their businesses will be more confident that the form of business they have selected will protect their personal assets if they are sued.

**H2b:** SB owners who seek counsel from either an accountant or an attorney (or both) when selecting a legal entity for their businesses will be more confident in their understanding of the liability protection they have with their entity type.

**H2c:** SB owners who seek counsel from either an accountant or an attorney (or both) when selecting a legal entity for their businesses will be more satisfied with their business entity choices than those who do not seek such advice.
H2d: SB owners who seek counsel from either an accountant or an attorney (or both) when selecting a legal entity for their businesses will be less likely to change business entity type than those who do not seek such advice.

H2e: SB owners who seek counsel from either an accountant or an attorney (or both) when selecting a legal entity for their businesses will be more satisfied that their business entity type has helped company profitability.

METHODOLOGY

A written survey was developed and distributed to founders of small businesses via students enrolled in an undergraduate Legal Environment (Business law) class at a metropolitan, mid-western university in 2005 (Fall). Each student in the class was required to contact a minimum of three separate firms and obtain one survey from each firm’s founder. They could receive extra credit for contacting three additional firms. Students were further required to attach the founder’s business card to a separate page on the survey instrument and were warned that submitting a falsified survey would result in the student being disciplined in accordance with the university’s Student Code of Conduct. This data collection methodology has been utilized in other similar studies (Goldsby et al 2005; McEvoy 1984; Hornsby and Kuratko 1990; Lyles et al. 1993; Kuratko, Hornsby, and Naftziger 1997).

Ten percent (51) of the founders surveyed were subsequently contacted by one of the authors via telephone to verify that the questionnaire had been completed by them. All 51 founders contacted verified that they had, in fact, completed the survey. A total of 513 useable surveys were collected. Of the 513 surveys collected, 91 percent were from firms located in three mid-western states (Kentucky, Ohio and Indiana). Prior to its use, the survey instrument was pre-tested using students enrolled in an Emerging Enterprise Law class. That survey generated 30 responses, also from the same geographic area. While open ended questions may have generated more in-depth responses, a structured survey (Appendix A) was utilized to increase reliability and validity.

FINDINGS

Tables 1 and 2 provide a description of the businesses in the sample as well as the types of businesses by business format. As indicated in Table 1, nearly 80 percent of the businesses in the sample were either S-corporations (32%), sole proprietorships (28%) or limited liability companies (19%). The legal structure of the remainder included C-corporations (14%) and partnerships (4%). Three percent (3%) listed other forms of legal structure.

Not surprisingly, sole proprietorships were much more likely to be smaller organizations, both in terms of the number of employees (93 percent had fewer than 10 employees) and the amount of revenues (89 percent had less than $500,000 in revenues). There were few differences among the types of business forms in the kinds of business (e.g. manufacturing, retailing) in which they are engaged. Sole proprietors were more likely than other business forms to be engaged in professional
services (36 percent) and less likely to be retailers (22 percent).

| Table 1 - Description of the Businesses in the Sample |
|----------------------------------|------------|
| **Business Format**              |            |
| S-Corporation                    | 32%        |
| Sole Proprietorship              | 28%        |
| Limited Liability Corporation    | 19%        |
| C-Corporation                    | 14%        |
| General Partnership              | 4%         |
| Other                            | 3%         |
| **Type of Business**             |            |
| Professional Services            | 28%        |
| Retailing                        | 27%        |
| Distribution                     | 6%         |
| Manufacturing                    | 6%         |
| Healthcare                       | 3%         |
| Other                            | 30%        |
| **Annual Revenues**              |            |
| Less than $100,000               | 22%        |
| $100,001-$250,000                | 17%        |
| $250,001-$500,000                | 17%        |
| $500,001-$750,000                | 5%         |
| $750,001-$1,000,000              | 7%         |
| More than $1,000,000             | 32%        |
| **Number of Employees**          |            |
| 0                                | 10         |
| 1-10                             | 59         |
| 11-20                            | 11         |
| 21-50                            | 11         |
| 51-100                           | 4          |
| More than 100                    | 4          |
Factors Influencing the Business Formation Decision

The businesses in the sample indicated that a number of factors influenced the decision to select a specific business form. The most common responses were tax implications (60 percent of the respondents), the need for liability protection (58 percent), the cost of business formation (33 percent), and concerns about financing (22 percent).

The vast majority of respondents obtained some advice before making their legal structure decision. The most common sources of information were accountants (59 percent), an attorney (50 percent), and friends or colleagues (29 percent). Respondents that eventually decided to form their businesses as sole proprietorships were less likely to have sought the advice of accountants or lawyers. We divided the respondents into two groups, those who had received advice from either an attorney or an accountant or both (n=366) and those who had received advice from neither an accountant nor an attorney (n=146).

There were significant differences in some of the responses of those who had sought the advice of an accountant/lawyer in their business formation decisions and those who had not used these professional services. As indicated in Table 3, respondents who had sought the advice of an accountant or an attorney (or both) were significantly more likely (p<.01) to say that tax implications and liability protection influenced their business formation decisions. Thus, H1a and H1b are supported. However, there were no differences between the two groups (those who sought professional services...
Table 3 - Factors Influencing the Business Formation Decision  
(Percentage of Respondents)

<table>
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<tr>
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<th>Overall</th>
<th>Sought advice from accountant/lawyer (or both)</th>
<th>No advice</th>
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<tbody>
<tr>
<td>Tax Implications(^1)</td>
<td>60%</td>
<td>69%</td>
<td>38%</td>
</tr>
<tr>
<td>Liability Protection(^2)</td>
<td>58%</td>
<td>66%</td>
<td>38%</td>
</tr>
<tr>
<td>Cost of Formation(^3)</td>
<td>33%</td>
<td>30%</td>
<td>43%</td>
</tr>
<tr>
<td>Financing Concerns(^4)</td>
<td>22%</td>
<td>21%</td>
<td>24%</td>
</tr>
</tbody>
</table>

\(^1\) Significant at p<.01 (\(\chi^2 = 41.29, \text{ df}=1\))  
\(^2\) Significant at p<.01 (\(\chi^2 = 32.28, \text{ df}=1\))  
\(^3\) Significant at p<.01 (\(\chi^2 = 57.55, \text{ df}=1\))  
\(^4\) Not significant (\(\chi^2 = .63, \text{ df}=1\))

and those who did not) in their beliefs that financing concerns influenced their business formation decisions. Thus, no support is found for H1c. Respondents who had sought the advice of an accountant/attorney were significantly less likely (p<.01) to say that the cost of forming a business influenced the type of business that they formed. Thus, H1d is supported.

**Satisfaction with the Legal Structure Decision**

The results in Table 4 indicate that the majority of respondents were satisfied with their company's form of business organization. Also, more than 70 percent of the companies were “not at all likely” to change their current form of business. It was hypothesized that business owners who had sought advice from an accountant/attorney would be more satisfied with their legal entity choices than business owners who had not used these professional services. However, there was found to be no significant difference between the two groups in either their degree of satisfaction with their form of business (t = .219, df = 508) or their likelihood of changing their form of business (t = .329, df = 507). Thus, there is no support for H2c and H2d.

However, respondents who had sought the advice of an accountant/attorney were more confident than their counterparts who had not sought professional advice that their forms of business would protect their personal assets if they are sued (p < .01, t = 3.96, df = 505), and were more confident in their understanding of the liability protection that they possess (p < .05, t = 2.07, df = 505) significantly more likely (p<.01, t = 2.44, df = 508). Thus, H2a and H2b are supported. Also, respondents who had sought the advice of an accountant/attorney were more likely to say that their choices of business entity had helped their business’s profitability (p < .02, t = 2.40, df = 508). Thus, H2e is also supported.
DISCUSSION

The descriptive findings indicate that SB owners surveyed in this research are typical of the population of U.S. small businesses. The distribution of entity types reported is similar to the distribution reported in the National Federation of Independent Business (NFIB) national small business poll data (2003) with one exception. Our sample had fewer businesses, on average, registered as C-corporations. One explanation for this difference is in the size of businesses in this sample. Nearly 70 percent of the small businesses included in this study had 10 or fewer employees. Thus, our findings are likely to be more reflective of, and pertinent to, very small or micro-enterprises. On the other hand, the number of C-corporations is declining with new entity forms available so this sample may be more reflective of the current SB owner today.

The authors found mixed support for the H1 set of hypotheses which focused on the factors identified as important in making the decision about legal entity type. Not surprisingly, when SB owners do not seek professional advice when making a decision about legal form, they are often singularly focused on the ease and cost of formation associated with their entity choice (H1d). We expected SB owners to be more likely to consider the full spectrum of strategic implications of legal entity type (liability protection, tax implications and financing) when they seek advice from professionals such as attorneys and accountants. However, we found that while this held true for liability protection (H1a) and tax implications (H1b), the SB owners surveyed who sought professional advice were not more likely to consider the impact of choice of entity on options for business financing (H1c). This may be because our sample of small firms was skewed towards very small firms, and the majority of micro-firms do not typically seek equity financing (the financing form most affected by legal structure). However, another explanation may be that some accountants and attorneys may not be well versed in the nuances of equity financing and the issues associated with legal structure and thus, may not have discussed this issue with their SB clients. More research is needed on this topic.

With respect to satisfaction and confidence (H2a-e), we again find mixed

| Table 4 - Satisfaction with Form of Business Organization (Percentage of Respondents) |
|----------------------------------------|-------------------------------|
| Extremely Satisfied                   | 1                             | 26%                          |
|                                      | 2                             | 31                           |
|                                      | 3                             | 15                           |
|                                      | 4                             | 12                           |
|                                      | 5                             | 7                            |
|                                      | 6                             | 7                            |
| Not at all Satisfied                  | 7                             | 2                            |
support for our hypotheses. SB owners who obtained professional advice regarding entity type were more confident that their legal form would protect their personal assets if they were sued than those who did not seek professional advice (H2a), and they were more confident in their understanding of the liability protection afforded by their legal structure (H2b). Surprisingly, SB owners who sought professional advice were no more satisfied with their entity choice than those who did not seek such advice (H2c). Moreover, SB owners who did not seek professional advice are no more likely to change entity form than those who did obtain professional counsel on this decision (H2d). One explanation for these findings might be that SB owners who do not obtain advice simply do not know what they don’t know. Again, this may be even more prevalent among micro firms. The typical micro business may not have sufficient resources to obtain on-going and comprehensive professional advice and they may lack the complementary skills of a management team.

When the respondents were asked which of the four factors were most important in influencing their decision, there were two factors that were cited as primary reasons. In all cases except sole proprietors, the tax implications and liability protection were the two primary reasons they chose the entity form that they did. In contrast, sole proprietors were more likely to cite cost of startup as the primary factor in choosing this entity type for their new business. This is likely due to the simplicity and low cost of starting a sole proprietorship compared to the other forms of business. However, it is surprising that this group also identified financing concerns as more important than those business owners organized as LLCs or as corporations. Follow up research may help clarify this finding.

Most importantly, we found support for our hypothesis that SB owners who seek professional advice regarding legal entity form are more confident that the legal structure they chose, and its resultant tax implications, has led to more profitability for their firm (H2e). This finding supports the notion that professional advice regarding legal choice is important for a firm in spite of the fact that this advice is often required in the very early stages of the business when finances are most often bootstrapped and the entrepreneur is least likely to feel that he/she can afford such assistance.

IMPLICATIONS AND FUTURE RESEARCH

While theory development in entrepreneurship has grown exponentially over the past two decades, academic research on legal issues related to new venture creation has not kept pace. New opportunities for entrepreneurs to gain strategic advantages from legal decisions continue to abound as laws related to business formation are created and modified on a regular basis. It is important that we continue to examine the role of legal matters in new venture strategy and report those findings to entrepreneurs and educators.

This study examined strategic implications of legal entity choice among SB owners by comparing the
factors that influenced their decisions about entity selection and the resultant satisfaction and confidence in entity selection among two primary groups – SB owners who sought professional advice of accountants and attorneys and those that did not. The findings were mixed and may have been due to the concentration of micro businesses among the firms sampled. Future research may show that micro enterprises differ from their larger small business counterparts with respect to several important issues. For example, they may lack a top management team or may lack the resources to obtain professional advice from accountants and attorneys. Those respondents who did seek advice from accountants or attorneys were more likely to consider factors other than cost and ease of formation and were also more confident that their personal assets were protected and that their entity selection positively impacted their profitability. Future research is needed to verify these findings. This research was based on a sample of 513 founders collected via survey. Qualitative methods may offer important richer insights and may clarify some of the results from this study.

The findings of this study are important to SB founders, advisors and educators. Despite the mixed findings of this research, the authors did find evidence that those SB owners who seek advice from accountants and attorneys view the entity selection decision more strategically than those who do not. They consider more than one factor when choosing entity type and are more confident in the impact of the decision on their ability to protect their personal assets and gain profits in their businesses. Thus, based on these findings, one might advise SB owners that when selecting their entity type, they need to consider the long term strategic implications of their entity selection process instead of viewing this as a perfunctory decision that must be made in order to move on to the more “important” tasks at hand in the day to day operation of their business. As one of the first decisions to be made, founders are likely to be lacking clear strategic and financial objectives. Thus, a founder should be advised to do the important work of developing strategy prior to entity selection. Moreover, saving money by not hiring qualified professionals to aid with entity selection can actually result in significant cost to the company in the long term. The value of an attorney and accountant who are well versed in the startup process and who understand the long term implications to the firm of various legal entity forms cannot be underestimated.

The findings of this research are also important to legal and financial advisors. Generally, these professionals are appropriately focused on ensuring they provide sound legal or financial advice to their clients. Some of those who frequently work with startups have learned the importance of also factoring in the long term goals and strategies of the founder into this decision. This process may be as simple as including a requirement that clients include strategic goals in their checklist of information they provide to their counselor or advisor, or a requirement that clients seek advice from both an accountant and a lawyer instead of just one.

Finally, it is important that entrepreneurship students understand the strategic nature of choosing an appropriate legal structure. Yet, while
most textbooks include a discussion of the attributes of the most common entity types, there are very few that approach this subject from a strategic perspective. For example, the attributes of common entity types are often considered independently and not holistically. Good educational materials that can help the entrepreneurship educator better understand and explain this subject to future entrepreneurs are needed.

Future research should include more in-depth qualitative and/or longitudinal data that can delve into the finer-grained aspects of issues associated with the impact of entity type on various business outcomes (e.g. exposure to risk, tax obligations, and financing opportunities and challenges). This research could examine why SB founders changed entity types and, having done so, what impact the change had on the business. Additional research could examine the impact of entity selection on a wide variety of outcomes such as profitability, tax positioning and exit/harvest results. Surveys or interviews with professional service providers (accountants and attorneys) regarding their perceptions of the preparedness of their SB clients for making this decision might also shed light on the questions associated with the entity selection process.

REFERENCES


Entrepreneurship and Small Business Institute Directors Association Annual Meeting, Orlando, FL.


Giles T. Hertz is an Assistant Professor of Business Law and Entrepreneurship at the University of Tampa. His research interests include entrepreneurship education, entrepreneurial finance and legal issues associated with the new venture creation process.

Fred Beasley is a Professor of Marketing at the University of South Carolina at Beaufort. His research interests are in marketing research and marketing for early stage companies.

Rebecca J. White is the James W. Walter Distinguished Chair of Entrepreneurship at the University of Tampa. Her primary research and teaching interests are in entrepreneurial finance, funding strategies for startup firms and strategic leadership in entrepreneurial firms.

APPENDIX

FORM OF BUSINESS ORGANIZATION QUESTIONNAIRE

Anyone that operates a business does so based upon some form of business organization, whether it is a sole proprietorship, partnership, corporation or some hybrid form. Each one of these forms of business organization has its own distinct characteristics.

The purpose of this survey is to answer the following questions: (1) Why do businesspersons choose one form of business organization over another, and (2) once having selected a form of business organization, how has that selection impacted the continued operation of the business?

Please Note: This survey may utilize the phrase “entity type” interchangeably when referring to the form of business organization concept.

1. Current Business Form:
   ___ Sole Proprietorship   ___ General Partnership   ___ Limited Partnership
   ___ C-Corporation         ___ S-Corporation        ___ Limited Liability Co.
   ___ Personal Service Corp. ___ Other (describe)__________________________
2. From which of the following sources did you receive advice or information on business form selection: (check all that apply)
   ___ lawyer     ___ accountant     ___ friend or colleague     ___ self-help books
   ___ none (skip next question)     ___ other (describe)____________________________________

3. Who or what was the primary source of advice or information on business form selection: (check only one)
   ___ lawyer     ___ accountant     ___ friend or colleague     ___ self-help books
   ___ other (describe)____________________________________

4. The following is a list of factors that may have influenced your decision to choose one form of business organization over another: (check all that apply)
   ___ cost of formation     ___ liability protection     ___ tax implications
   ___ financing concerns     ___ other (describe)____________________________________

5. Please rank those factors that you identified in the previous question based upon their relative importance to your decision-making: (circle or check appropriate response)

   Cost of Formation:
   _____________________________
   1 2 3 4 5 6 7
   Not at all important Very important

   Liability Protection:
   _____________________________
   1 2 3 4 5 6 7
   Not at all important Very important

   Tax Implications:
   _____________________________
   1 2 3 4 5 6 7
   Not at all important Very important

   Financing Concerns:
   _____________________________
   1 2 3 4 5 6 7
   Not at all important Very important

   Other:
   _____________________________
   1 2 3 4 5 6 7
   Not at all important Very important
6. When you started your business, did you prepare your own formation documents? (e.g. partnership agreement, articles of incorporation, etc): ___Yes ___No ___N/A

If you answered No to Question 6, please skip to Question 9 and continue the survey. If you answered N/A to Question 6, please skip to Question 11, and continue the survey.

7. How would you rate the ease of preparing and filing your own formation documents? (circle or check appropriate response)

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<tr>
<td>Difficult</td>
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<td></td>
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<td>Easy</td>
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8. Having previously prepared and filed your own formation documents, would you do it again if you were to start another business? (circle or check appropriate response)

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<tbody>
<tr>
<td>Never do it again</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Would do it again</td>
</tr>
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</table>

9. If you did not prepare your own formation documents when you started your business, please indicate who prepared the documents on your behalf:

___ Solo Practitioner Attorney ___ Small Law Firm (1-10 attorneys)
___ Medium Size Law Firm (11-20 attorneys) ___ Large Law Firm (over 21 attorneys)
___ Other (describe) ____________________________

10. What legal services did your attorney/law firm provide during your company’s start-up? (check all that apply)

___ Advice; ___ Basic Formation Documents Only;
___ Acquired Federal Tax ID Number; ___ By-Laws/Operating/Partnership
Agreements; ___ Served as Incorporator (corps. only); ___ Corporate Resolutions &
Minutes; ___ Other (describe) ___________________

11. Is the same ___ attorney ___ law firm that provided legal services during the startup phase of your company currently providing legal services to your company? ___Yes; ___No

12. Please estimate the cost of legal services related to the legal formation of your business entity: ___ ≤ $500; ___ $501 - $1,000; ___ $1,001 - $2,000; ___ $2,001 - $3,000;
___ $3,001 - $4,000; ___ $4,001 - $5,000; ___ $5,001 - $7,500; ___ $7,5001 - $10,000;
___ > $10,000.
13. Do you purchase any of the following business insurance? If so, please check all that apply:
   ___ Casualty (fire, theft, etc.)   ___ Vehicle   ___ Product Liability
   ___ Liability   ___ Workers’ Comp.   ___ Errors & Omissions
   ___ Business Interruption   ___ Directors/Officers   ___ Other __________________

14. How confident are you that your current insurance coverage is adequate to safeguard your business operations in the event your business is sued? (circle or check appropriate response)

   1  2  3  4  5  6  7
   Not at all confident   Very Confident

15. How confident are you that your form of business will protect your personal assets in the event your business is sued? (circle or check appropriate response)

   1  2  3  4  5  6  7
   Not at all confident   Very Confident

16. How confident are you in your knowledge and understanding of the liability protection that your form of business provides for your personal assets? (circle or check appropriate response)

   1  2  3  4  5  6  7
   Not at all confident   Very Confident

Because of recent changes in the tax law (check the box rules), a business may elect to be taxed as an entity that is not the same as the form of its business (e.g. a partnership may elect to be taxed as a corporation).

17. Indicate how your current business has elected to be taxed: (it may or may not be the same as your response to Question No. 1).
   ___ Sole Proprietorship   ___ General Partnership   ___ Limited Partnership
   ___ C-Corporation   ___ S-Corporation   ___ Limited Liability Co.
   ___ Personal Service Corp.   ___ Other (describe)_________________________

18. How satisfied are you with your business’ current tax election: (circle or check appropriate response)

   1  2  3  4  5  6  7
   Extremely satisfied   Not at all satisfied
19. Has your company’s current tax election hindered or helped your business’s profitability? (circle or check appropriate response)

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<thead>
<tr>
<th>Greatly hindered</th>
<th>Neutral</th>
<th>Greatly helped</th>
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<td></td>
<td>(Don’t Know)</td>
<td></td>
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20. If there were no negative tax implications (i.e. a capital gain) associated with electing a different tax status other than the one currently in place, how likely would you be to elect a different tax status? (circle or check appropriate response)

<table>
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<tr>
<th>Not at all likely to change</th>
<th>Neutral</th>
<th>Extremely likely to change</th>
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<td>(Don’t Know)</td>
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21. During the start-up phase of your business did you seek debt financing (bank loans, etc.) for your company? ___Yes ___No. If you answer No, skip to Question 23 and continue.

22. During the start-up phase of your business, did your company’s form of business organization hinder or help your ability to attract debt financing? (circle or check appropriate response)

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<th>Greatly hindered</th>
<th>Neutral</th>
<th>Greatly helped</th>
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23. During the start-up phase of your business did you seek equity financing (sale of stock, ownership %, etc.) for your company? ___Yes ___No. If you answer No, skip to Question 25 and continue.

24. During the start-up phase of your business, did your company’s form of business organization hinder or help your ability to attract or acquire equity financing? (circle or check appropriate response)

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<th>Greatly hindered</th>
<th>Neutral</th>
<th>Greatly helped</th>
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25. After your company was up and running, did you ever seek debt financing (bank loans, etc.) for your company? ___Yes ___No. If you answer No, skip to Question 27 and continue.
26. After your company was up and running, did your company’s form of business organization hinder or help your ability to attract or acquire debt financing? (circle or check appropriate response)

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<td></td>
<td>Greatly hindered</td>
<td>Neutral</td>
<td>Greatly helped</td>
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27. After your company was up and running, did you ever seek equity financing (sale of stock, ownership %, etc.) for your company? Yes  No. If you answer No, skip to Question 29 and continue.

28. After your company was up and running, did your company’s form of business organization hinder or help your ability to attract or acquire equity financing? (circle or check appropriate response)

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<tbody>
<tr>
<td></td>
<td>Greatly hindered</td>
<td>Neutral</td>
<td>Greatly helped</td>
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29. Are you currently satisfied with your company’s form of business organization? (circle or check appropriate response)

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<tbody>
<tr>
<td></td>
<td>Extremely satisfied</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Not at all satisfied</td>
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30. How likely are you to change your company’s current form of business organization? (e.g. converting from a partnership to LLC) (circle or check appropriate response)

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<tbody>
<tr>
<td></td>
<td>Not at all likely to change</td>
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<td></td>
<td>Extremely likely to change</td>
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31. Have you previously changed entity types: Yes; No; If No, skip to Question 33 and continue the survey.

32. Initial form of business:

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<tr>
<td></td>
<td>Sole Proprietorship</td>
<td>General Partnership</td>
<td>Limited Partnership</td>
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<tr>
<td></td>
<td>C-Corporation</td>
<td>S-Corporation</td>
<td>Limited Liability Co.</td>
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<tr>
<td></td>
<td>Personal Service Corp.</td>
<td>Other (describe)</td>
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</tbody>
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Company Demographics:

33. Name of business: _______________________________________________________

34. State and County of formation: State___________; County____________________

35. Year of formation: ____________________________

36. Type of Business: (check appropriate response)
___ Manufacturing; ___ Distribution; ___ Retail; ___ Professional Services;
___ Bio-Tech; ___ High-Tech; ___ Education ___ Health Care ___ Other

37. Number of employees:
___ 0; ___ 1-10; ___ 11-20; ___ 21-30; ___ 31-50; ___ 51-75; ___ 76-100; ___ >100

38. Average Annual Revenue/Sales:
___ < $100,000. ___ $100,001-$250,000 ___ 250,001-$500,000
___ $500,001-$750,000 ___ $750,001-$1,000,000 ___ >$1,000,000.

THANK YOU for taking time out of your busy schedule to complete this survey. Please indicate if you would be willing to participate in future research projects regarding this topic. ___ YES ___ NO