1.3: Advantages of Corporations

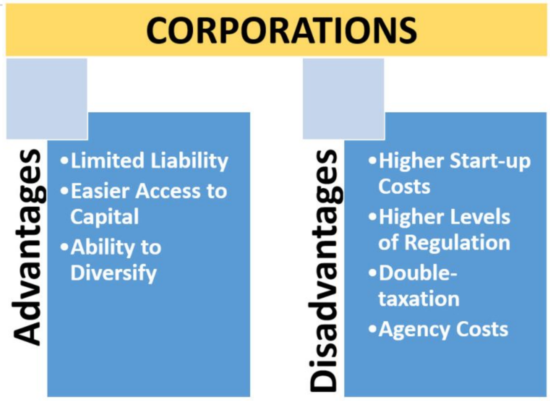

Figure 1.3.1: Advantages and disadvantages of corporations

Limited Liability

Due to the separation between business and the owners, stockholders are typically not liable for anything beyond their initial investment. When buying a share of stock and becoming an owner in a corporation, an individual can lose his entire initial investment if the company goes bankrupt, but nothing beyond that. Remember that this is not the case for sole proprietorships or general partnerships.

Easier access to capital

Corporations have access to the capital markets by issuing shares of stock or issuing bonds. This makes it easier to raise large sums of money for expansion or a multi-year, profitless startup that is anticipated to generate significant profits after the startup stage. Sole proprietorships and partnerships find it much more difficult to raise significant amounts of capital. Snap, Inc. (Snapchat) is an example of a limited liability corporation that recently became a publicly traded corporation via an Initial Public Offering, IPO. The Snap IPO was offered March of 2017 with an original price of $17 per share. Upon opening, demand for the popular IPO pushed the price to $24 per share (a 44% increase) giving the company a $32 billion dollar valuation. Despite several red flags investors continued to purchase Snap stock. The company had yet to see an operating profit, losing $500 million in 2016 and $372 million in 2015, and its net worth for 2016 was a mere $1.5 billion. Over the following few months the stock price gradually fell, trading significantly below its original offering price of $17 per share (all the way down to about $5 per share in Dec. 2018). As of January 2021, Snap is trading for around $50 per share, lost just over $1 billion in 2019 and is worth over $70 billion. See the current price of Snap.

Ability to Diversify Ownership

Corporations allow individuals to own multiple businesses without having expertise in all (or even any) of these businesses. This allows an investor (owner) to reduce her risk and take advantage of opportunities that would not be accessible without corporations. The chance of an investor owning multiple businesses in different industries as a sole proprietorship is minut (due to time, capital and expertise issues). Alternatively, it is easy for an individual to invest $5000 into a mutual fund and become a part owner of hundreds or thousands of different businesses.