

1.4: Disadvantages of Corporations

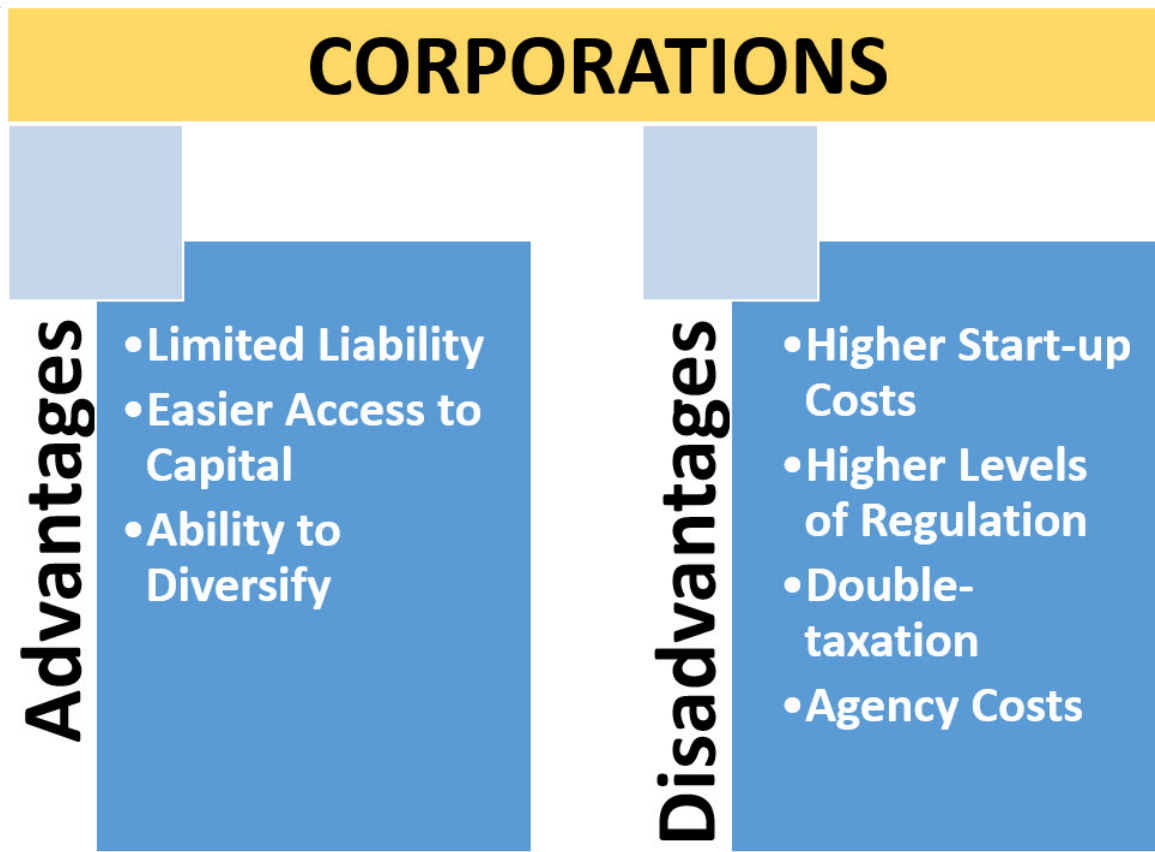


Figure 1.4.1: Advantages and disadvantages of corporations

Higher start-up costs and higher levels of regulation

Because there is a separation between the owners and the business, there are higher regulatory costs associated with keeping owners informed about business operations. Publicly traded corporations must follow SEC guidelines pertaining to registration and reporting (such as audited annual and quarterly reports) that are costly. According to a [report by Protiviti in 2016](#), the average firm spent between \$1,113,000 and \$1,442,000 in internal compliance costs to comply with Sarbanes-Oxley regulations. This is just one of the regulatory costs associated with being a corporation. These expenses lower the profitability of the company, but may be necessary to protect shareholders.

Double-taxation

Because the owners and the business are treated as two separate entities under the corporate form of ownership, both are taxed. The business must pay corporate income taxes on any income it makes. When investors make money through dividends (a distribution of corporate profits to owners) or through capital gains (an increase in the value of a share of stock) these are taxable. The current tax code taxes dividend income and long-term capital gains at a lower rate than ordinary income which substantially reduces (but does not eliminate) the impact of double-taxation. Given the volatile nature of tax codes, the impact of double-taxation is likely to fluctuate over time.

Agency Costs

This topic will be discussed in more detail later, but essentially, it is the idea that the owners of the company are not handling the decision-making. Therefore, there is the potential for the decision-makers to run the firm more in their own self-interest rather than in the best interest of the owners (shareholders).

While our focus will be on the corporation, many of the same ideas apply to other types of [business organizations](#) (such as sole proprietorships, partnerships – limited or general, S corporations and limited liability companies) as well as personal financial

decisions.

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