

## Why form a company?

There are a number of reasons why people choose to incorporate a company rather than one of the other business types. Limited liability

- Continuity of existence
- Transferability of shares
- Marketplace credibility
- Control by shareholders

## Limited liability

The primary reason for selecting a limited liability company is the protection that it affords to shareholders. This is because once a company is formed, it is regarded as a separate legal entity from its shareholders.

This concept of limited liability becomes important if the company is unable to pay its debts and a liquidator is appointed. Shareholders of a limited liability company are not liable for the business debts of the company unless:

They have not fully paid for their shares prior to the company being placed in liquidation. In this case they are liable to the liquidator for any unpaid money owing on their shares.

They have given personal guarantees to lenders or creditors, such as banks or suppliers.

They are also directors of the company and have 'traded recklessly'.

By contrast a sole trader or a person trading in partnership will always be exposed and personally liable for business debts that cannot be met by business funds.

## Note

Although it is common to speak of a 'limited liability company' it is in fact the liability of the shareholders that is limited. The company is liable in full for all obligations that it incurs.

## Continuity of existence

A company will continue to exist until it is removed from the register. It can often survive many changes in ownership or management.

By contrast, a sole trader business ceases to exist if the trader dies or stops trading. Similarly, in the case of a partnership the retirement or death of a partner usually brings that partnership to an end.

### **Transferability of shares**

Shareholders may sell or otherwise dispose of their shares at any time (subject to any restriction imposed in the company's constitution). This makes a company much easier to sell or pass on to others (such as your children) than other business structures.

A partnership interest, on the other hand, is generally not able to be assigned or transferred (you have to end the partnership).

### **Marketplace credibility**

As an internationally recognised business structure, the limited liability company structure enjoys greater credibility and a more professional image in the marketplace than the sole trader option. This is why many businesses in New Zealand start as sole traders, but upgrade to the company status once they become established.

### **Control by shareholders**

In many smaller New Zealand companies the shareholders are also the directors of the company. Often the largest shareholder is the managing director. In larger companies most shareholders have no say in its daily operations.

However, all shareholders that hold voting shares in a company may participate in the election and removal of directors. This gives shareholders the collective right to elect the directors and have the ultimate control of the company without necessarily being concerned in its day-to-day affairs.