Business structures – sole trader or company?

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If you start a business, it is important to choose the right structure. In this article, we'll look at the two most common business structures: companies and sole traders. Often a company will be a good choice, so we'll end with some tips for running a company.

Sole Trader

Many people operate their business as a sole trader largely because you don't need to do anything to set it up. All you need to do is start trading. As your business grows, you can employ or contract people to help you. There are also fewer compliance obligations – though you need to be aware of rules that apply to businesses generally, like tax.

There are some downsides to being a sole trader. The main one is that all liability is personal to you. If your business runs into trouble and you owe people money, you might have to repay debts by selling your personal assets (e.g. car, house, savings).

Being a sole trader can also make it difficult to attract investors or bring in people to help run the business. If you do want to grow your business and have others provide cash or expertise, then a company is generally a better choice.

Company

A company is quite different to a sole trader. A company is 'incorporated', meaning it has a separate legal identity. You don't employ staff or enter contracts – your company does. Companies can also have multiple directors and shareholders, making it a flexible structure for having cofounders or attracting investment.

Perhaps the most important difference is that companies have limited liability. This means that – unlike a sole trader – if the business owes money, generally the company (not you) has to pay. Even though you might be the company's driving force (and director/shareholder), your personal assets are usually not at risk. At least, until you sign a personal guarantee or breach your director's duties – but that's a different story.

You can register a company relatively easily on the NZ Companies Office website, and it doesn't cost a lot or take very long. In simple cases, you may not even need a lawyer or accountant to help you.

The downside to a company is that you (as a director of the company) have certain duties and compliance obligations. For example, you need to act in good faith and in the best interests of the company. You will also have to keep your company records up to date and comply with the Companies Act. However, once you are aware of your duties and compliance obligations, they are generally manageable and should become part of how you run your business.

Which structure is best?

The answer here is that it will really depend on the business – there is no one size fits all. Generally speaking, a company is a good choice if you:

- will be in business with others (i.e. cofounders);
- want to grow your business, and may need investment to do so; or
- face risks or liability if things go wrong, and want to help protect yourself against those risks.

Certain businesses or industries may favour a specific structure. There are also other options (like trusts or limited partnerships) that may be more appropriate depending on your specific circumstances. You can often change your structure later, although it may end up costing you money or an opportunity.

If in doubt, talk with a professional or do some research online – a company is often a good choice if you're serious about starting a business. If you do have a company, make sure you:

- enter into contracts under your company name, not your personal name;
- understand and comply with your company law obligations;
- get advice to maximise your opportunities; and
- try to avoid signing personal guarantees unless you have to.

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