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Business

A Changing World
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Part 2

Chapter 4

Starting and Growing a Business

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CHAPTER 4

Options for Organizing Business

CHAPTER 5

Small Business, Entrepreneurship, and Franchising

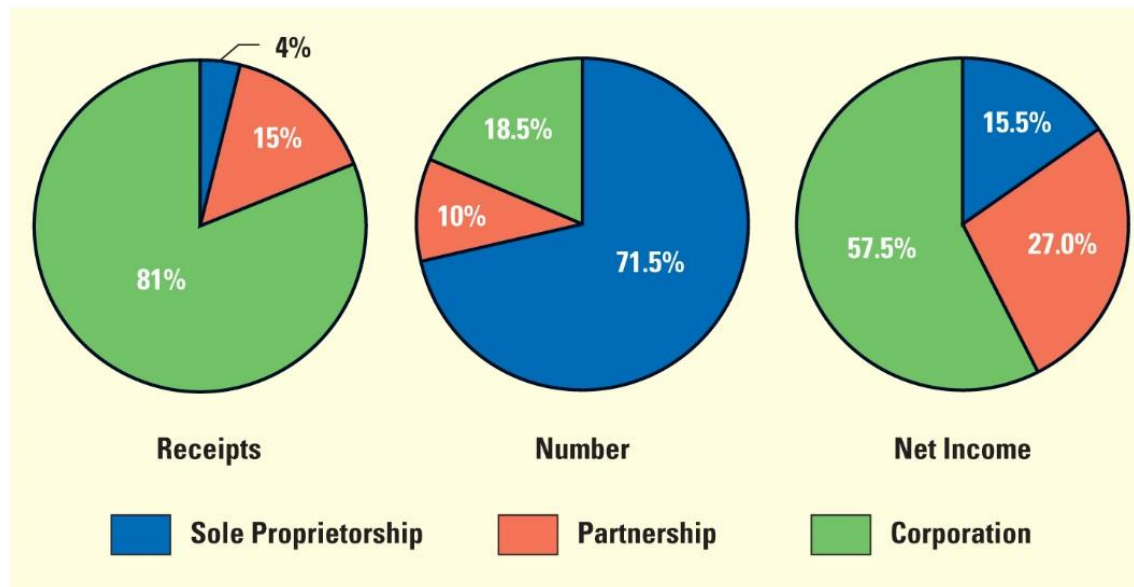
Learning Objectives

- LO 4-1** Define and examine the advantages and disadvantages of the sole proprietorship form of organization.
- LO 4-2** Identify two types of partnership, and evaluate the advantages and disadvantages of the partnership form of organization.
- LO 4-3** Describe the corporate form of organization, and cite the advantages and disadvantages of corporations.
- LO 4-4** Define and debate the advantages and disadvantages of mergers, acquisitions and leveraged buyouts.
- LO 4-5** Propose an appropriate organizational form for a startup business.

Introduction (1 of 2)

- Comparison of Sole Proprietorships, Partnerships and Corporations

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Introduction (2 of 2)

Structure	Ownership	Taxation	Liability	Use
Sole Proprietorship	One owner	Individual income taxed	Unlimited	Owned by a single individual/easiest way to conduct business
Partnership	Two or more owners	Individual owners' income taxed	Somewhat limited	Easy way for two individuals to conduct business
Corporation	Any number of shareholders	Corporate and shareholder taxed	Limited	Legal entity with shareholders or stockholders
S Corporation	Up to 100 shareholders	Taxed as a partnership	Limited	Legal entity with tax advantages for restricted number of shareholders
Limited Liability Company	Unlimited number of shareholders	Taxed as a partnership	Limited	Avoid personal lawsuits

Sole Proprietorship

- **Sole Proprietorship**

- Businesses owned and operated by one individual; the most common form of business organization in the United States

- Many focus on services rather than manufacturing
 - Typically employ fewer than 50 people
 - Comprise nearly three-quarters of all U.S. companies
 - Men are twice as likely as women to start their own business

Advantages of Sole Proprietorship

✓ Advantages

- Ease and cost of formation
- Allow a high level of secrecy
- Owner keeps all profits
- Flexibility and control of the business
- Government regulation is minimal
- Taxes paid only once
- Can be dissolved easily

Disadvantages of Sole Proprietorship

✓ Disadvantages

- Unlimited liability
- Scarce external funding
- Owners need diverse skills
- Success is tied to the owner
- Lack of qualified employees
- Higher taxation

Finding Talented Employees

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- **Sole proprietorships have greater difficulty attracting talented employees**
 - ✓ Large corporations such as McDonald's have better profits and more job opportunities
 - ✓ Difficult to match the wages and benefits offered by large corporations
 - ✓ Little chance for advancement within sole proprietorship



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Entrepreneur

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- » This entrepreneur opened his small business as a sole proprietorship
- » As sole proprietor, he keeps his profits but is personally responsible for all risks and financial obligations

Partnership

- **Partnership**

- A form of business organization defined by the Uniform Partnership Act as “an association of two or more persons who carry on as co-owners of a business for profit”
 - One way to minimize the disadvantages of sole proprietorship and maximize its advantages is to have more than one owner
 - Typically larger than sole proprietorships but smaller than corporations
 - Partnerships can be a fruitful form of business as long as you follow some keys to success

Types of Partnerships

- **General Partnership**

- Involves a complete sharing in both the management and the liability of the business

- **Limited Partnership**

- Has at least one general partner, who assumes unlimited liability, and at least one limited partner whose liability is limited to his or her investment in the business

- **Articles of Partnership**

- Legal documents that set forth the basic agreement between partners

Advantages of Partnerships

✓ Advantages

- Easy to organize
- Availability of capital & credit
- Combined knowledge and skills
- Swift decision making
- Government regulations are few

Disadvantages of Partnerships

✓ Disadvantages

- Unlimited liability
- Responsible for each others' decisions
- A new agreement is needed if the partnership changes
- Difficult to sell a partnership interest
- Distribution of profits may be uneven
- Cannot find external funding as easily as large corporations

Partnerships and Taxes

- Partnerships are quasi-taxable organizations
 - ❖ Partnerships do not pay taxes but do file a tax return providing information on profitability and distribution of profits
 - ❖ Partners report their share of the profits and pay taxes at the income tax rate for individuals



Keys to Success in Business Partnerships

- ❖ Keep profit sharing and ownership at 50/50, or you have an employer/employee relationship
- ❖ Partners should have different skill sets to complement one another
- ❖ Honesty is critical
- ❖ Must maintain face-to-face communication in addition to phone and e-mail
- ❖ Maintain transparency, sharing more information over time
- ❖ Be aware of funding constraints, and do not put yourself in a situation where neither you nor your partner can secure additional financial support
- ❖ To be successful, you need experience
- ❖ Whereas family should be a priority, be careful to minimize the number of associated problems
- ❖ Do not become too infatuated with “the idea” as opposed to implementation
- ❖ Couple optimism with realism in sales and growth expectations/planning

Google

- » In 1996 Stanford students Sergey Brin and Larry Page partnered to form the search engine Google as part of a research project
- » The company was incorporated in 1998 and is now the world's top search engine

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Corporation

- **Corporation**

- A legal entity, created by the state, whose assets and liabilities are separate from its owners
- Has many of the rights, duties and powers of a person
 - Can own and transfer property
 - Can enter into contracts
 - Can sue and be sued in court
- Account for the majority of all U.S. sales and income

Stock and Dividends

Corporations are typically owned by many individuals and organizations who own shares of the business

- **Stock**

- Shares of the corporation that may be bought or sold
- Can also be gifted or inherited

- **Dividends**

- Profits of a corporation that are distributed in the form of cash payments to the stockholders

Creating Corporations

- Incorporators create the corporation
- Following state procedure of chartering the corporation
- Incorporators file legal articles of incorporation with the state
- State issues a legal corporate charter to the company
- Owners establish bylaws and board of directors

Types of Corporations

- **Domestic Corporation**

- If conducting business in the state in which it is chartered

- **Foreign Corporation**

- If conducting business outside the state in which it is chartered

- **Alien Corporation**

- If conducting business outside the nation in which it is incorporated

American Companies with More than Half of Their Revenues from Outside the U.S.

Company	Description
Caterpillar Inc.	Designs, manufactures, markets, and sells machinery, engines, and financial products
Dow Chemical	Manufactures chemicals, with products including plastics, oil, and crop technology
General Electric	Operates in the technology infrastructure, energy, capital finance, and consumer and industrial fields, with products including appliances, locomotives, weapons, lighting and gas
General Motors	Sells automobiles including Chevrolet, Buick, Cadillac, and Isuzu
IBM	Conducts technological research, develops intellectual property including software and hardware, and offers consulting services
Intel	Manufactures and develops semiconductor chips/microprocessors
McDonald's	Operates second-largest chain of fast-food restaurants worldwide
Nike	Designs, develops, markets, and sells athletic shoes/clothing
Procter & Gamble	Sells consumer goods including Tide, Bounty, Crest, Iams
Yum! Brands	Operates/licenses restaurants including Taco Bell, KFC, Pizza Hut

Private Corporations and Initial Public Offering

- **Private Corporation**

- Owned by just one or a few people who are closely involved in managing the business
- None of their stock is sold to the public
- Private companies are not required to disclose financial information publicly

- **Initial Public Offering (IPO)**

- Selling a corporation's stock on public markets for the first time
- Done when a private corporation wishes to “go public” or to raise additional capital and expand

Mars Corporation

- ❖ The snack and food company Mars is privately owned by the Mars family
- ❖ The company became one of the world's largest candy makers when Mars purchased chewing-gum company Wm. Wrigley Jr. Co. in 2008



Public Corporations

- **Public Corporations**

- A corporation whose stock anyone may buy, sell, or trade
- Two types of public corporations
 - **Quasi-Public**
 - Owned and operated by the government
 - Provides a service but often operates at a loss
 - **Nonprofit**
 - Focuses on providing a service rather than making a profit
 - Not owned by the government

Board of Directors

- A group of individuals, elected by the stockholders to oversee the general operation of the corporation, who set the corporation's long-range objectives
- ✓ The board is responsible for meeting objectives on schedule
- ✓ Legally liable for mismanagement or misuse
- ✓ An important duty is to hire corporate officers

Inside Directors are employees of the company

Outside Directors are people unaffiliated with the company

Preferred and Common Stocks

- **Preferred Stock**

- A special type of stock whose owners, though not generally having a say in running the company, have a claim to profits before other stockholders do

- **Common Stock**

- Stock whose owners have voting rights in the corporation, yet do not receive preferential treatment regarding dividends
 - May vote by *proxy*, allows stockholders to assign their voting privilege to someone else
 - Have *preemptive right*, they can buy any new shares of stock the company issues

Preferred Stock

- Owners of preferred stock have first claim to profits
- Dividend payments on preferred stocks are usually a fixed percentage of the initial issuing price (set by the board of directors)
 - If a share of preferred stock originally cost \$100 and the dividend rate was stated at 7.5%, the dividend payment will be \$7.50 per share per year

Advantages of Corporations

✓ Advantages

- Limited liability
- Ease of transfer of ownership
- Perpetual life
- Securing funding is easier than for other forms of business
- Expansion potential

Disadvantages of Corporations

✓ Disadvantages

- Double taxation
- Expensive to form
- Disclosure of information to the government and the public
- Owners and managers are not always the same and can have different goals

Volkswagen

- Volkswagen is the eighth-largest corporation in the world
- Did You Know?
 - The first corporation with a net income of more than \$1 billion in one year was General Motors, with a net income in 1955 of

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Hostile Takeovers

- ✓ Hostile takeovers occur when one individual or company attempts to buy a majority share in the company for the purpose of restructuring the management team and/or the board of directors
- ✓ They are different from mergers and acquisitions because there is no mutual agreement for the transfer of company ownership
- ✓ Many times, companies that are vulnerable to hostile takeovers will institute a “poison pill”, which works to dilute the value of company stock making it less attractive for the individual or company to purchase a majority share of the company
- ✓ The poison pill can also serve to decrease the stock value of the takeover company if they follow through with the takeover

Joint Venture and S Corporation

- **Joint Venture**

- A partnership established for a specific project or for a limited time
- Control can be divided equally, or one partner may control decision making
- Used for ventures that call for large investments, such as development of new products

- **S Corporation**

- Corporation taxed as though it were a partnership with restrictions on shareholders
- Eliminates double taxation and retains the limited liability benefit
- Very popular with entrepreneurs, representing nearly half of all corporate filings

Limited Liability Company and Cooperatives

- **Limited Liability Company (LLC)**
 - Form of ownership that provides limited liability and taxation like a partnership but places fewer restrictions on members
 - Considered a blend of the best characteristics of corporations, partnerships and sole proprietorships
- **Cooperatives or Co-ops**
 - Organizations composed of individuals or small businesses that have banded together to reap the benefits of belonging to a larger organization
 - Set-up not to make money as an entity but so members can become more profitable or save money

Consumer Cooperative REI

- REI is organized as a consumer cooperative
- REI operates a bit differently because it is owned by consumers rather than farmers or small businesses

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Employee-Owned Businesses

Employee-owned companies have proven to be successful on many fronts whether the company is large or small

- ✓ Employees who have ownership tend to have a higher sense of loyalty to the company because there is a mutual interest between the two
- ✓ Two types of employee ownership structures
 - ✓ Equity benefit plan: offers employee a stake in the company without voting rights
 - ✓ Employee-controlled company: all are considered owners and may have varying degrees of voting rights

Mergers

- **The combination of two companies (usually corporations) to form a new company**

- ✓ **Horizontal merger**

- ◆ Firms that make and sell similar products to the same customers merge

- ✓ **Vertical merger**

- ◆ Companies operating at different but related levels of an industry merge

- ✓ **Conglomerate merger**

- ◆ Firms in unrelated industries merge

Google Acquisitions

- ✧ In 2013, Google paid \$3.2 billion for smart home company, Nest Labs
- ✧ Just one of many that Google acquired during the year
- ✧ These acquisitions have the potential to diversify Google's service offerings and benefit it financially
 - ✧ Some believe Google might be investing in companies of which it has little knowledge
 - ✧ Acquisitions could end up harming the acquiring company

Trends in Business Ownership (1 of 2)

- **Acquisition**

- The purchase of one company by another, usually by buying its stock

- **Corporate raider**

- A company or individual who wants to acquire or take over another company and first offers to buy some or all of its stock at a premium in a *tender offer*

- **Poison pill**

- The firm allows stockholders to buy more shares of a stock at lower prices than the current market value to head off a hostile takeover

Trends in Business Ownership (2 of 2)

- **Shark repellent**
 - Management requires a large majority of stockholders to approve a takeover
- **White knight**
 - A more acceptable firm that is willing to acquire a threatened company

Leveraged Buyout

- A purchase in which a group of investors borrows money from banks and other institutions to acquire a company (or a division of one), using the assets of the purchased company to guarantee repayment of the loan
 - ✓ Mergers and acquisitions (particularly the *merger mania* in the late 20th century) have been criticized
 - ✓ Executives have to focus excessively on avoiding takeovers, not on managing the business

Build Your Skills

Selecting a Form of Business (1 of 2)

Ali Bush sees an opportunity to start her own website development business

▶ Ali has a master's degree in computer science

▶ Has most of the computer equipment necessary

◆ She needs additional software

▶ She feels she can take this start-up firm and create a long-term career opportunity for herself and others

◆ Can work out of her apartment's extra bedroom

◆ As the business grows, hire the additional full- and/or part-time help needed and reassess the location of the business

Build Your Skills

Selecting a Form of Business (2 of 2)

► TASK

- Using what you've learned in this chapter, decide which form of business ownership is most appropriate for Ali
- Evaluate the advantages and disadvantages of each business ownership

Discussion

- ? Name five advantages of a sole proprietorship.
- ? Differentiate among the different types of corporations. Can you supply an example of each type?
- ? Would you rather own preferred stock or common stock? Why?
- ? Which form of business requires the most specialization of skills? Which requires the least? Why?