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BASIC FORMS OF BUSINESS OWNERSHIP

Hundreds of thousands of people have started new businesses in the United States. In fact, more than 600,000 are started each year.[1] Chances are, you've thought of owning your own business or know someone who has.

How you form your business can make a tremendous difference in your long-term success. The three major forms of business ownership are (1) sole proprietorships, (2) partnerships, and (3) corporations. Each has advantages and disadvantages that we'll discuss.

It can be easy to get started in your own business. You can begin a lawn mowing service, develop a website, or go about meeting other wants and needs of your community. A business owned, and usually managed, by one person is called a **sole proprietorship**. That is the most common form of business ownership.

Many people do not have the money, time, or desire to run a business on their own. When two or more people legally agree to become co-owners of a business, the organization is called a **partnership**.

Sole proprietorships and partnerships are relatively easy to form, but there are advantages to creating a business that is separate and distinct from the owners. This is a **corporation**, a legal entity with authority to act and have liability apart from its owners. The almost 5 million corporations in the United States make up only 20 percent of all businesses, but they earn 81 percent of total U.S. business receipts (see Figure 5.1).[2]

SOLE PROPRIETORSHIPS

1. *Ease of starting and ending the business.* All you have to do to start a sole proprietorship is buy or lease the needed equipment (a saw, a laptop, a tractor, a lawn mower) and put up some announcements saying you are in business. You may have to get a permit or license from the local government, but often that is no problem. It is just as easy to get out of business; you simply stop. There is no one to consult or disagree with about such decisions.
2. *Being your own boss.* Working for others simply does not have the same excitement as working for yourself—at least, that's the way sole proprietors feel. You may make mistakes, but they are your mistakes—and so are the many small victories each day.
3. *Pride of ownership.* People who own and manage their own businesses are rightfully proud of their work. They deserve all the credit for taking the risks and providing needed goods or services.

4. *Leaving a legacy.* Owners can leave an ongoing business for future generations.
5. *Retention of company profits.* Owners not only keep the profits earned but also benefit from the increasing value as the business grows.
6. *No special taxes.* All the profits of a sole proprietorship are taxed as the personal income of the owner, and the owner pays the normal income tax on that money. However, owners do have to pay the self-employment tax (for Social Security and Medicare). They also have to estimate their taxes and make quarterly payments to the government or suffer penalties for nonpayment.

Disadvantages of Sole Proprietorships

1. *Unlimited liability—the risk of personal losses.* When you work for others, it is their problem if the business is not profitable. When you own your own business, you and the business are considered one. You have **unlimited liability**;

2. *Limited financial resources*. Funds available to the business are limited to what the one owner can gather. Since there are serious limits to how much money one person can raise, partnerships and corporations have a greater probability of obtaining the financial backing needed to start and equip a business and keep it going.
3. *Management difficulties*. All businesses need management; someone must keep inventory, accounting, and tax records. Many people skilled at selling things or providing a service are not so skilled at keeping records. Sole proprietors often find it difficult to attract qualified employees to help run the business because often they cannot compete with the salary and benefits offered by larger companies.

PARTNERSHIPS

A partnership is a legal form of business with two or more owners. There are several types: (1) general partnerships, (2) limited partnerships, and (3) master limited partnerships. In a **general partnership** all owners share in operating the business and in assuming liability for the business's debts. A **limited partnership** has one or more general partners and one or more limited partners. A **general partner** is an owner (partner) who has unlimited liability and is active in managing the firm. Every partnership must have at least one general partner. A **limited partner** is an owner who invests money in the business but does not have any management responsibility or liability for losses beyond his or her investment. **Limited liability** means that the limited partners' liability for the debts of the business is *limited* to the amount they put into the company; their personal assets are not at risk.

CORPORATIONS

Many corporations—like General Electric, Microsoft, and Walmart—are big and contribute substantially to the U.S. economy. However, it's not necessary to be big to incorporate. Incorporating may be beneficial for small businesses as well.

A **conventional (C) corporation** is a state-chartered legal entity with authority to act and have liability separate from its owners—its *stockholders*. Stockholders are not liable for the debts or other problems of the corporation beyond the money they invest in it by buying ownership shares, or stock, in the company. They don't have to worry about losing their house, car, or other property because of some business problem—a significant benefit. A corporation not only limits the liability of owners but often enables many people to share in the ownership (and profits) of a business without working there or having other commitments to it. Corporations may choose whether to offer ownership to outside investors or remain privately held. (We discuss stock ownership in Chapter 19.) Figure 5.4 describes various types of corporations.


Owners/stockholders
(elect board of directors)
Board of directors
(hire officers)
Officers
(set corporate
objectives and
select managers)
Managers
(supervise employees)
Employees

COMPARISON OF FORMS OF BUSINESS OWNERSHIP

		PARTNERSHIPS		CORPORATIONS		
	SOLE PROPRIETOR-SHIP	GENERAL PARTNERSHIP	LIMITED PARTNERSHIP	CONVENTIONAL CORPORATION	S CORPORATION	LIMITED LIABILITY COMPANY
Documents Needed to Start Business	None; may need permit or license	Partnership agreement (oral or written)	Written agreement; must file certificate of limited partnership	Articles of incorporation, bylaws	Articles of incorporation, bylaws, must meet criteria	Articles of organization and operating agreement; no eligibility require-ments
Ease of Termination	Easy to terminate: just pay debts and quit	May be hard to terminate, depending on the partnership agreement	Same as general partnership	Hard and expensive to terminate	Same as conventional corporation	May be difficult, depending upon operating agreement
Length of Life	Terminates on the death of owner	Terminates on the death or withdrawal of partner	Same as general partnership	Perpetual life	Same as conventional corporation	Varies according to dissolution dates in arti-cles of organization
Transfer of Ownership	Business can be sold to qualified buyer	Must have other partner(s)' agreement	Same as general partnership	Easy to change owners; just sell stock	Can sell stock, but with restrictions	Can't sell stock

Financial Resources	Limited to owner's capital and loans	Limited to partners' capital and loans	Same as general partnership	More money to start and operate; may sell stocks and bonds	Same as conventional corporation	Same as partnership
Risk of Losses	Unlimited liability	Unlimited liability	Limited liability	Limited liability	Limited liability	Limited liability
Taxes	Taxed as personal income	Taxed as personal income	Same as general partnership	Corporate, double taxation	Taxed as personal income	Varies
Management Responsibilities	Owner manages *all* areas of the business	Partners share management	Can't participate in management	Separate management from ownership	Same as conventional corporation	Varies
Employee Benefits	Usually fewer benefits and lower wages	Often fewer benefits and lower wages; promising employee could become a partner	Same as general partnership	Usually better benefits and wages, advancement opportunities	Same as conventional corporation	Varies, but are not tax deductible

CORPORATE EXPANSION: MERGERS AND ACQUISITIONS

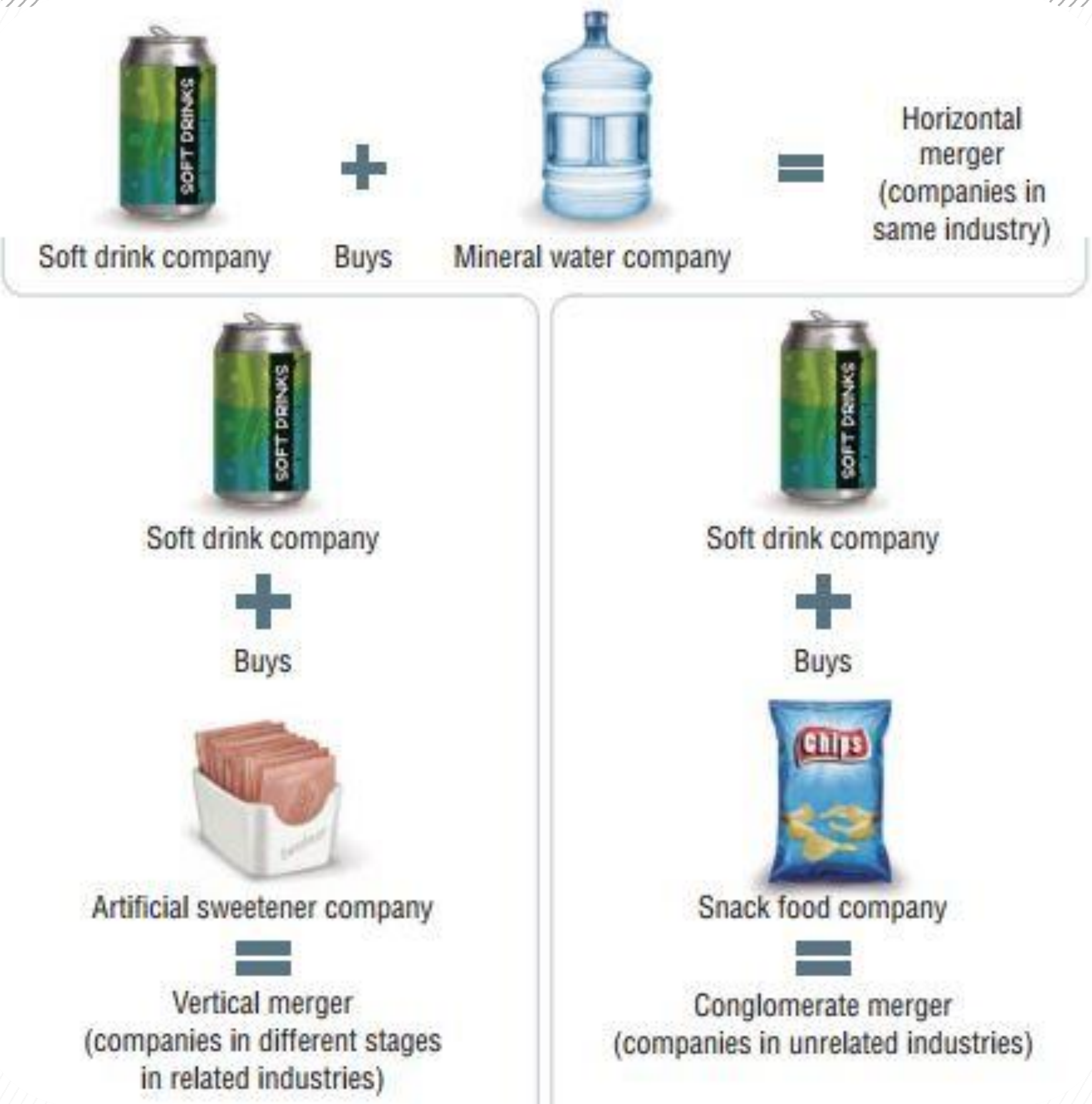
merger
The result of two firms forming one company.

acquisition
One company's purchase of the property and obligations of another company.

vertical merger
The joining of two companies involved in different stages of related businesses.

horizontal merger
The joining of two firms in the same industry.

conglomerate merger
The joining of firms in completely unrelated industries.


Soft drink company
Buys
Mineral water company
Horizontal merger (companies in same industry)
Soft drink company
Buys
Artificial sweetener company
Vertical merger (companies in different stages in related industries)
Soft drink company
Buys
Snack food company
Conglomerate merger (companies in unrelated industries)

FRANCHISES

franchise agreement
An arrangement whereby someone with a good idea for a business sells the rights to use the business name and sell a product or service to others in a given territory.

franchisor
A company that develops a product concept and sells others the rights to make and sell the products.

franchise
The right to use a specific business's name and sell its products or services in a given territory.

franchisee
A person who buys a franchise.

Giving Entrepreneurs Options with Digital Franchising

Chris Jeffrey noticed something strange about the restaurants in his college town: few of them posted their menus online. And when an eatery did have a website, ordering food through it was usually out of the question. Sensing an opportunity, Jeffrey developed his own online restaurant ordering service after graduation. Called OrderUp, the site lets users scroll through various restaurants located in their area. Once they've decided what they'd like to eat, customers can place their order and either pick it up or have it delivered. OrderUp then sends the payment to the restaurant, minus a small commission.

Jeffrey's early success with the concept made him eager to expand. But potential investors wanted too large a stake in the business, leaving Jeffrey afraid that he could be forced out of his own company. So instead, he offered to franchise OrderUp digitally, something that had never been done before in the business world. Although investors weren't interested in such a risky venture, Jeffrey carried on and developed a tempting offer for potential franchisees. For a start-up fee of $42,000, franchisees receive software and training to launch an OrderUp operation in their area. The franchisee maintains exclusive rights to sell the service within their territory while the company itself handles order processing and customer service. This digital franchising model keeps costs low while giving franchisees the time to focus on convincing restaurants to join OrderUp. So far Jeffrey's 20 digital franchisees have generated more than $30 million in food orders annually. Expect to see them in your town soon, or if you're prepared to take the risk, bring them there yourself by becoming an OrderUp franchisee!

Sources: Minda Zetlin, "Digital Franchises: New Spin on an Old Business Model," *Inc.*, March 7, 2013; "Business Opportunities: OrderUp," www.entrepreneur.com, accessed February 2014; and www.franchise.orderup.com, accessed February 2014.

THE AGE OF THE ENTREPRENEUR

- Avon, the familiar beauty products retailer, started in 1886 with $500 David McConnell borrowed from a friend.
- George Eastman launched photographic giant Kodak in 1880 with a $3,000 investment.
- Procter & Gamble, now a multinational marketer of household products, was formed in 1837 by William Procter, James Gamble, and a total of $7,000 in capital.
- Ford Motor Company began with an investment of $28,000 by Henry Ford and 11 associates.
- Amazon.com began with investments by founder Jeff Bezos's family and friends. Bezos's parents invested $300,000, a huge portion of their retirement account. Today they are billionaires.

What Does It Take to Be an Entrepreneur?

Self-directed. You should be self-disciplined and thoroughly comfortable being your own boss. You alone will be responsible for your success or failure.

Self-nurturing. You must believe in your idea even when no one else does, and be able to replenish your own enthusiasm. When Walt Disney suggested the possibility of a full-length animated feature film, *Snow White*, the industry laughed. His personal commitment and enthusiasm caused the Bank of America to back his venture. The rest is history.

Action-oriented. Great business ideas are not enough. Most important is a burning desire to realize, actualize, and build your dream into reality.

Highly energetic. It's your business, and you must be emotionally, mentally, and physically able to work long and hard. Employees have weekends and vacations; entrepreneurs often work seven days a week and don't take vacations for years. Working 18-hour days in your own business can be exhausting, but most entrepreneurs think it is better than working long hours for someone else.

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That’s all. Thank you! ☺

Any Questions?