

Unit 5

Business Ownership and Planning

Web Quest

Internet Project

Be Your Own Boss

Have you ever thought that you would like to be your own boss? Would you like to own your own spa, restaurant, or gas station? Business ownership is the dream of all entrepreneurs, and it is never too early to explore the opportunities. In this project, you will think about how to start or acquire your own business. You will also find out more about what entrepreneurs do, and learn where to get help on the road to success.



Log on to finance07.glencoe.com. Begin by reading Task 1. Then continue on your WebQuest as you study Unit 5.

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Good Works— with a Business Plan

Just a decade ago, there were virtually no B-school courses or student projects on social entrepreneurship. Today most top business schools have both.

But before such a subject can be taught, it must be defined. A social entrepreneur is one driven by a social mission, a desire to find innovative ways to solve social problems that are not being or cannot be addressed by the market or the public sector. *How to Change the World: Social Entrepreneurs and the Power of New Ideas* by David Bornstein adopts this broad definition. Well-documented cases of grassroots entrepreneurial activities to tackle such diverse social problems as child abuse, disability, illiteracy, housing, and environmental degradation give life to it.

The search for financing has sparked a wave of entrepreneurship within the field of social investment, including firms dedicated to investing in businesses that deliver solutions to social problems. Let's hope that in the process, they help restore the public's trust in the business community.

—By Laura D'Andrea Tyson

 **Write About It** What are some examples of successful businesses that help society?

 **Log On** To read the complete *BusinessWeek* article and do the *BusinessWeek* Extension activity to learn more about business ownership and financial management, go to finance07.glencoe.com.

CHAPTER 16

Types of Business Ownership



What You'll Learn

When you have completed this chapter, you will be able to:

Section 16.1

- Identify the advantages and disadvantages of a sole proprietorship.
- Explain the differences between general and limited partners.
- Identify the advantages and disadvantages of a partnership.

Section 16.2

- Describe two types of corporations.
- Summarize the process of forming a corporation.
- Discuss the advantages and disadvantages of a corporation.

Reading Strategies

To get the most out of your reading:

Predict what you will learn in this chapter.

Relate what you read to your own life.

Question what you are reading to be sure you understand.

React to what you have read.

In the Real World . . .

Michaela Garnett began pet-sitting in high school. She had good instincts for dealing with animals, so her father suggested she get a part-time job at a pet store while going to college. Main Street Pet Emporium needed extra help and hired Michaela to work three days a week. However, the owner was about to retire and sell the store. So Michaela approached her bank, and with her father's help, made a deal to buy the store. She knew that customers loved the cats and dogs offered, but they also wanted exotic fish and parrots. With these new pets, the store's profits increased. The business is a partnership, but friends have encouraged her to incorporate it. Michaela needs to find out more about the types of business ownership.

As You Read Consider what type of ownership would best suit a small business.

ASK STANDARD & POOR'S

Business Ownership

Q: In a sole proprietorship, you get to keep all the profits for yourself. Why would I want to have all

the hassles of setting up a corporation?

A: Each type of business structure offers advantages and disadvantages. The net income from a sole proprietorship is taxed at personal income tax rates, but a corporation's profits are taxed at lower, corporate tax rates. However, a sole proprietorship is easier to set up, so you could be in business more quickly.

Ask Yourself Why might you set up a business as a sole proprietorship?



Go to finance07.glencoe.com to complete the Standard and Poor's Financial Focus activity.

Section 16.1

Focus on Reading



Read to Learn

- How to identify the advantages and disadvantages of a sole proprietorship.
- How to explain the differences between general and limited partners.
- How to identify the advantages and disadvantages of a partnership.

Main Idea

Understanding and selecting the proper form of organization for your business can be an essential factor in its success.

Key Terms

- sole proprietorship
- Employer Identification Number (EIN)
- unlimited liability
- limited life
- partnership
- partnership agreement
- general partner
- limited partner

Before You Read



PREDICT

What might be an advantage of owning your own business? A disadvantage?

Sole Proprietorship and Partnership

Business Ownership Organization

Are there different kinds of business ownership?

Understanding how to handle your personal finances can help prepare you for managing your own business. The abilities to plan, manage, and keep track of your own money can be applied to handling a business. If you decide to start a business and manage its finances, it is important to become familiar with the different types of ownership.

When you start a business, you have a choice as to how the ownership is legally organized. Business ownership can take one of three legal forms: sole proprietorship, partnership, or corporation. It is important to select the most appropriate form of ownership that best suits your needs and the needs of your business. This section will examine the first two forms of business ownership—sole proprietorship and partnership.

Sole Proprietorship

What are the characteristics of a sole proprietorship?

The word *sole* means “single” or “one.” The word *proprietor* means “owner.” A **sole proprietorship**, therefore, is a business owned by one person. The sole proprietorship is the oldest and most common form of business ownership. Approximately 75 percent of all businesses in the United States today are organized as sole proprietorships. Although many people think of corporations when they think about business in the United States, the sole proprietorship is the backbone of American business.

Most sole proprietorships are small-business operations, each owned by an individual. An individual who starts a business is known as an *entrepreneur*. Many of these businesses provide services, such as auto repair, house cleaning, carpentry, or plumbing. They generally operate out of homes, small offices, or storefronts. Some sole proprietorships become quite successful, but many go out of business. In all cases, however, the owners of sole proprietorships are pursuing their dreams of running their own businesses.

For example, Debbi Fields had a dream of selling cookies. She created a highly successful business called *Mrs. Fields Cookies*. John Johnson wanted to start a magazine. So he borrowed \$500 from his family and created the successful magazine *Ebony*. Even some major corporations began as risky ventures by entrepreneurs. The company Corning would not exist without Amory Houghton, and there would be no Colgate-Palmolive without the determination of William Colgate.

Advantages of Sole Proprietorship

Organizing a business as a sole proprietorship has several advantages. The most important advantage is having the freedom to make all the decisions. This form of business organization also has other advantages. You receive all profits and pay tax once a year as an individual. This type of business has easy set-up, simple licensing and paperwork, and few government regulations.

Easy Set-Up A sole proprietorship is the easiest form of business organization to set up. Although local and state governments require some paperwork, you can usually complete this without much difficulty. Starting a sole proprietorship does take some effort, but because a minimal amount of documentation is required, the cost of organizing a sole proprietorship is relatively low.

Licensing In many cases, you can organize a sole proprietorship by simply obtaining a license to do business from your local or state government. You might also need to obtain a state sales tax number because you may be required to collect sales tax on any products you sell to customers.

Business Name If you are planning to operate under a business name other than your own name, you must apply for a *Certificate of Doing Business Under an Assumed Name*. This is also referred to as a *DBA*, which stands for “Doing Business As.” For example, Celia Jontos wants to start a personalized wedding planning service, *Time to Remember*. In order to operate legally under this business name, Ms. Jontos will need to get a DBA certificate.

Employees If you intend to hire one or more employees to work in your business, you will need an Employer Identification Number. An **Employer Identification Number (EIN)** is a number assigned by the Internal Revenue Service, which is used for income tax purposes. Many sole proprietors hire managers and several employees. Some large companies, which are also organized as sole proprietorships, have hundreds of employees.



▲ **SMALL BUSINESS IS BIG**
Small businesses have traditionally been the backbone of the American economy.
What small businesses have started in your area recently?

Careers in Finance



GENERAL CONTRACTOR

Carolyn King
Self-Employed

Carolyn is a natural planner and leader. As a general contractor, she helps homeowners, landlords, and businesses construct, remodel, or repair their buildings. She may bid to take part of a job—for example, fixing a kitchen—or oversee an entire project. Carolyn must know prices and plan for expenses. Whether she handles the entire job or subcontracts parts of the job to electrical, heating, and plumbing specialists, Carolyn is responsible for the job being done on time and according to the budget. General contractors enjoy the challenge of working on different types of jobs and the satisfaction of putting together teams that are right for each project.

SKILLS: Accounting, communication, decision-making, management, math, negotiation, organization, problem-solving, and time-management skills

PERSONAL TRAITS: Highly motivated, leadership, able to work independently as well as with others

EDUCATION: High school diploma or equivalent; or bachelor's degree in construction science; experience in the field; and contractor's license exam

ANALYZE Why would a general contractor need to have good money-management skills?



To learn more about career paths for general contractors, visit finance07.glencoe.com.

Total Control As a sole proprietor, you can run your business as you wish. This is a great advantage because you do not have to convince partners, stockholders, or other people that your business decisions are sound. You can choose what merchandise to sell or services to provide, what prices to charge, and what hours you will work. As the sole owner of your own business, you make all management and financial decisions.

Profits to Owner With a sole proprietorship, when your business makes a profit, you can keep all of it (after you pay taxes). As your business grows and becomes more successful, you will receive larger profits. A sole proprietorship allows the owner to reap the rewards of hard work and determination.

Profits Taxed Once A business organized as a sole proprietorship does not pay income taxes as a company. You as the owner must declare the profits of the business on your personal income tax return. Tax is computed on your total income for the year. If you operate your business full-time, any profits you make will be counted as taxable income. If your business operates part-time and you also have a full-time job, your taxable income will include income from your job as well as the net income from your business.



Few Government Regulations Another benefit of operating as a sole proprietorship is that you do not have to complete and file many forms and reports with the state and federal governments. There may be some government regulations regarding the particular business, but most sole proprietors experience little government red tape.

Disadvantages of Sole Proprietorship

With most choices people make, there is a positive side and a negative side. Though organizing your business as a sole proprietorship has definite advantages, this form of business organization also has several drawbacks:

- Limited capital
- Unlimited liability
- Limited human resources
- Limited life

Limited Capital When you start a sole proprietorship, the only source of working capital, besides money you borrow, is your own money. Generally, no one else helps you finance the business. Moreover, the amount of cash available to you may be limited. Adequate funding and a positive cash flow are essential for a business. Without a sufficient amount of money to establish the business, begin operations, and expand, you could have serious difficulties. See Chapter 19 for a detailed discussion on sources of funding.

Unlimited Liability A major disadvantage of a sole proprietorship is that if your business is not successful, you are responsible for all losses. **Unlimited liability** is a situation in which the owner of the business is responsible to pay the business debts out of personal assets. In other words, if your business is unsuccessful, you could lose your car, home, savings, and other assets. If your business's financial situation is bad, you might have to declare personal bankruptcy.

Starting a new business involves a high risk. More than half of all new businesses fail within five years after being established. If your business fails, your personal financial position and credit rating could be seriously damaged.

Limited Human Resources An advantage of a sole proprietorship is that you are the only decision maker in the business. However, being the only person in charge can also be a disadvantage. When you are the sole owner of a business, you cannot rely on other individuals to help carry the load.

Most people have limited knowledge and talents. Perhaps you know a lot about certain goods or services, but your basic business skills are weak. For example, if you start a painting business, you may have skills in painting, be able to identify different types of paint, and know the proper way to apply paint to different surfaces. At the same time, you may have limited business experience in pricing, record-keeping, or advertising and marketing.

Savvy Saver

Checking Account Questions

1. How much money do I need to open a personal or small business checking account?
2. What are the monthly service charges?
3. Do I need to keep a minimum amount of money in my account?
4. Will my checking account earn interest?
5. Can I sign up for overdraft protection?



RELATE

With the skills you have now, do you think you would be able to start a sole-proprietorship business?

Poor decisions in purchasing, accounting, or marketing could ruin your business, even when you have a lot of knowledge about your product or service. A sole proprietor must be willing to hire the services of people whose different talents and skills will enhance the business.

Limited Life A sole proprietorship has a **limited life**, a situation in which a business's life span or existence is determined by the owner's life span or the owner's decision to terminate the business. The business may also legally end if sold to someone else. In that case, the new owner creates a new business in his or her name.

The Partnership

What are the characteristics of a partnership?

Some people choose to form a partnership when starting a business. A **partnership** is a business owned by two or more persons. Partners as co-owners agree voluntarily to operate the business for profit. When a partnership is formed, the partners sign a special legal agreement: A **partnership agreement** is a written document that states how the partnership will be organized. The agreement includes the following basic information:

- Names of the partners
- Name and nature of the business
- Amount of investment by each partner
- Duties, rights, and responsibilities of each partner
- Procedures for sharing profits and losses
- How assets will be divided when and if the partnership is dissolved

In a partnership you and your co-owners decide how to divide profits and losses from the business. You also outline the duties and responsibilities of each partner. All partners must agree to the conditions stated in the partnership agreement. The purpose of this written document is to prevent later disagreements among the partners.

About 5 percent of all businesses in the United States today are partnerships. However, some large companies began as partnerships before becoming corporations. For example, in 1876, an icebox maker named Abram Anderson started a partnership with a fruit merchant named Joseph Campbell. Their small partnership eventually grew to become a corporation, the Campbell Soup Company.

General Partners and Limited Partners

Within the category of partnerships, there are two basic types of partners: general partners and limited partners. In many partnerships, all partners are general partners. A **general partner** is a business partner who has decision-making authority, takes an active role in the operation of the business, and has unlimited liability for all losses or debts of the partnership. Every partnership has at least one general partner.

All general partners have what is known as agency power. Agency power, also known as *mutual agency*, is the right to sign contracts that are legally binding on the partnership. For example, suppose that Dylan, Juanita, and Charles form a partnership to make bookcases. Dylan goes to Clinton Wood Products and signs a contract to purchase wood from that company. Dylan acted on behalf of the business with agency power, and so the partnership is legally obligated under the contract.

A partnership can also add limited partners. A **limited partner** is a business partner who does not take an active role in decision making or in running the business. A limited partner's liability in the partnership is limited to the amount of his or her investment in the business. For example, Christa Clark, a limited partner in Low Country Furniture, invested \$25,000 in the business. Christa is not involved in running the business. Moreover, her financial liability is limited to her \$25,000 investment. That means if the business fails, the most she can lose is \$25,000.

Advantages of the Partnership

Many of the advantages of a partnership are similar to the advantages of a sole proprietorship. However, instead of being the only decision maker in a business, you would share decision making with your partners. More people can generate more ideas and possibly more money. There are several advantages of a partnership:

- Easy set-up
- More skills and knowledge
- Available capital
- Total control by partners
- Profits taxed once



◀ **YOU ARE THE BOSS** In a sole proprietorship, the owner makes all the decisions and takes all the responsibility. However, it is impossible for one person to be knowledgeable and skilled in all areas. *What skills and knowledge might a sole proprietor owner lack?*



Easy Set-Up A partnership is also relatively easy to set up. Although some paperwork is required, it is generally minimal. You may need to obtain certain local or state business permits or licenses. For some types of business operations, you must also know and follow various government regulations.

The most important legal document of a partnership is the partnership agreement. All the terms and conditions of the partnership must be clearly stated in this written document. Taking care to make the agreement as complete and clear as possible can help you to avoid misinterpretations and misunderstandings between partners as the partnership and business grow.

More Skills and Knowledge The skills and knowledge needed to operate the business in a sole proprietorship are the responsibility of just one person. In a partnership, however, the various partners can contribute different skills and experience. One person may have previous experience running a similar type of business. Another partner might have extensive business or accounting experience. A third partner might have excellent sales and marketing skills. The

pooling of talent and knowledge is an advantage that partnerships have over sole proprietorships.

Available Capital Several individuals in a business partnership can contribute more money to a business venture than one person acting alone with only personal assets. Moreover, if additional cash is needed to maintain or expand business operations, it can be easier to raise capital when several people are working to do so.

For example, in 1872, dry goods merchant Levi Strauss received a letter from one of his customers, a Nevada tailor named Jacob Davis. Davis had been making overalls for miners and had come up with a way to strengthen the pants by adding rivets to the seams. He wanted to patent his idea but could not afford the \$68 he needed to file the papers. He wrote to Strauss to suggest that they hold the patent together. When Strauss teamed up with Davis in 1873, Levi's® jeans became a reality.

Obtaining bank financing may be more feasible when more than one individual is responsible for the loan. Banks may also be more willing to loan greater sums of money to a partnership than to a sole proprietorship because the risk is shared among the partners.

The partners' credit ratings are very important. Avoid entering a partnership agreement with anyone who has a questionable credit rating. The ability of all partners to borrow money can be an important factor in the success or failure of a business.

▲ PROFESSIONAL PARTNERSHIPS

Partnerships are common among groups of professionals, such as architects, lawyers, and accountants.

Can you name groups of people in other occupations that might form partnerships?

As You Read



QUESTION

What are two advantages of a partnership over a sole proprietorship?



Learn to identify and understand the standard financial documents you will use in the real world.

Investigate: An Application for Employer ID Number

An IRS Form SS-4 contains the following information:

- Name and address of the business
- Type of business
- Date the business started
- Principal activity of the business

Your Motive: You may decide in the future to start your own business. When you establish a business, you are required by law to apply to the federal government for an employer identification number.

Form **SS-4** Application for Employer Identification Number
(Rev. December 2011)
Department of the Treasury Internal Revenue Service

1 Legal name of entity (or individual) or where the EIN is being acquired
Callahan Tree Service

2 Trade name of business (if different from name on line 1)

3a Executor, trustee, "trustee" name
Lee Callahan

3b Street address (if different) (Do not enter a P.O. box)

4a Mailing address (room, apt., suite o, and street, or P.O. box)
1537 Hardan Road

4b City, state and ZIP code
Lee, TX

5a City, state, and ZIP code

6 County and state where principal business is located
Tarrant TX

7a Name of principal officer, general partner, grantor, owner, or trustee
Lee Callahan

7b SSN, ITIN, or EIN

8a Type of entity (check only one box)
 Sole proprietor (SSN) _____
 Partnership _____
 Corporation (enter form number to be filed) _____
 Personal service corp. _____
 Church or church-controlled organization _____
 Other nonprofit organization (specify) _____
 Other (specify) _____

Estate (SSN of decedent) _____
 Plan administrator (SSN) _____
 Trust (SSN of grantor) _____
 National Guard _____ State/local government
 Farmers' cooperative _____ Federal government/military
 REMC _____ Indian tribal government/enterprise
Group Exemption Number (GEM) _____

8b If a corporation, name the state or foreign country State _____ Foreign country _____

9 Reason for applying (check only one box)
 Started new business (specify type) **Tree maintenance**
 Hired employees (Check the box and see line 12.) _____
 Compliance with IRS withholding regulations _____
 Other (specify) _____

Buying purpose (specify purpose) _____
 Changed type of organization (specify new type) _____
 Purchased going business _____
 Created a trust (specify type) _____
 Created a pension plan (specify type) _____

10 Date business started or acquired (month, day, year)
03/15/11

11 Closing month of accounting year
December

12 First date wages or annuities were paid or will be paid (month, day, year). Note: If applicant is a withholding agent, extended income will first be paid to nonresident alien. (month, day, year) _____
4/15/11

13 Highest number of employees expected in the next 12 months. Note: If the applicant does not expect to hire any employees during so period, enter "0."
Agricultural _____ Household _____ Other **3**

14 Check one box that best describes the principal activity of your business.
 Construction Rental & leasing Transportation & warehousing Health care & social assistance Wholesale-retailer Real estate Manufacturing Finance & insurance Accommodation & food service Wholesale-retailer Retail Other (specify) **Tree Trimming**

15 Indicate principal line of merchandise sold, specific construction work done, products produced, or services provided.
Cut and trim trees

Key Points: An employer sends an IRS Form SS-4 to the federal government. When received, the government assigns the employer a number. The Employer Identification Number (EIN) helps the government monitor taxes that a business is required to pay. Whenever taxes are paid, a business must provide its identification number.

Find the Solutions

1. Who should use the Form SS-4?
2. What is the purpose of this form?
3. What was the date that this business started?
4. In what state was this business incorporated?
5. What is the principal activity of the business?



Put on Your Financial Planner's Cap

After working for two years as a financial planner, you have decided to go out on your own. Determine how you want to establish your business: as a sole proprietorship, with a partner or as a limited partnership. Create a chart for each business type, comparing start-up funds, insurance needed, supplies needed, and type of advertising needed.

Total Control by Partners In a partnership the operation of the business is the sole responsibility of the general partners, who can do as they want. However, the partners are also responsible for the success or failure of the business.

Profits Taxed Once Like a sole proprietorship, a partnership is not taxed as a business. Therefore, it is not subject to state or federal income taxes. The partnership agreement states how the profits of the partnership should be divided. Each partner must pay personal income taxes to the state and federal government, based on his or her share of the profits received from the business. Thus, business profits are taxed only once.

Disadvantages of the Partnership

While a partnership can offer many advantages, a number of problems can arise when several people own and operate a business. This form of business ownership can avoid some of the problems associated with sole proprietorships, but it also has disadvantages:

- Unlimited liability
- Possible disagreement among partners
- Shared profits
- Limited life

In 1975, two young men named Bill Gates and Paul Allen formed a partnership to produce computer software. Today their company, Microsoft, is a major corporation, and Bill Gates and Paul Allen are two of the wealthiest people in the world. Microsoft is a partnership that turned into one of America's greatest success stories. However, most people never come close to this level of achievement. Many partnerships have very little success or eventually fail. Entering a partnership involves large financial risks.

Unlimited Liability Earlier in this section, you learned that the owner of a sole proprietorship has unlimited liability. The same is true of the general partners in a partnership. If the partnership loses money or has financial problems, each co-owner is personally responsible for all of the debts of the business. In other words, if your partnership fails and the debts of the business cannot be covered by its assets, you and your partners are responsible for paying the bills out of your own personal assets.

For example, two friends ask you to join them in forming a partnership. You have a large amount of personal assets. Your two partners have very few assets. If the business fails, you could end up being personally responsible for the majority of the business debts. You could even lose everything you own. It is very important to choose your business partners carefully. Know the personal financial position and credit ratings of each partner. Remember, each general partner has unlimited liability for the entire business, not just part of it.



Disagreement among Partners When several people manage a business, they may not always agree on important business decisions. A common reason for failed partnerships is that the partners have serious conflicts about how the business should operate, and they allow the business to suffer financially from these conflicts.

Shared Profits Hard work on your part may be the crucial factor in the success of the business. Nevertheless, you still must share the profits with your partners. The way in which the profits of the business are divided is outlined in the partnership agreement.

Limited Life The life of a partnership depends on the willingness and ability of the partners to continue in business together. A partnership has a limited life, and partnerships can end for a number of reasons. Perhaps a partner dies or decides to retire or withdraw from the partnership due to illness. The partners may disagree and decide to end their partnership, or they may decide to add new partners. In these situations, the original partnership dissolves. The remaining partners and any new partners should then draw up a new partnership agreement, which will create a new business.

Section 16.1 Assessment

QUICK CHECK

1. What is an advantage of being a sole proprietor?
2. What is the difference between a general partner and a limited partner?
3. What are several disadvantages of a partnership?

THINK CRITICALLY

4. In your opinion, what is the most important element of a partnership agreement? Explain your answer.

USE COMMUNICATION SKILLS

5. **Perturbed Partners** Lawrence and Tyrell are partners in a small retail business. They sell hats and T-shirts from a kiosk in a shopping mall. Recently they have been thinking about selling other items as well, but they cannot agree on what items to add to their product line. Their disagreements have caused the business to suffer financially.



Write About It What advice would you offer Lawrence and Tyrell to help them work out their differences? What solutions would you suggest? Write down your suggestions for them.

SOLVE MONEY PROBLEMS

6. **Business Ownership Decisions**

Pamela owns a pet-sitting business. People hire her to take care of their pets when they go out of town. As part of her service, Pamela also brings in her clients' mail and waters their plants. Her business is booming, and she needs to make some critical decisions about its future.



Analyze Help Pamela decide what to do now. Should she expand her business? Add employees? Take on a partner? Make sure that you evaluate the advantages and disadvantages of each suggestion you offer as you outline your suggestions on paper.

Section 16.2

Focus on Reading



Read to Learn

- How to describe two types of corporations.
- How to summarize the process of forming a corporation.
- How to discuss the advantages and disadvantages of a corporation.

Main Idea

A typical form of business organization is the corporation, which is in operation all over the world.

Key Terms

- corporation
- articles of incorporation
- corporate bylaws
- corporate charter
- board of directors
- limited liability company (LLC)
- franchise

Before You Read



PREDICT

What might be an advantage of a corporation?

The Corporation

What Is a Corporation?

What is the difference between a corporation and other businesses?

You have probably heard the word *corporation*. A number of large corporations exist nationally and globally, such as IBM, General Motors, Hershey Foods, Sony, Hewlett-Packard, Motorola, Xerox, and Goodyear. A corporation is another form of business ownership that is different from a sole proprietorship or a partnership.

A **corporation** is a business organization that operates as a legal entity that is separate from its owners and is treated by law as if it were an individual person. A corporation can do everything that a sole proprietorship or a partnership can do—own property, buy and sell merchandise, pay bills, and make contracts. It can also sue and be sued in the court system. About 20 percent of businesses in the United States are organized as corporations, but they produce about 90 percent of the total business revenue in the United States.

Starting a Corporation

What is the process of forming a corporation?

When you form a corporation, you create a legal entity. This process is more complex than starting a sole proprietorship or a partnership.

Paperwork and Documents

To create a corporation, you must file an application with the state for permission to operate. The application to operate as a corporation is called the **articles of incorporation**. The application includes information such as the corporate name and the type of business in which the corporation will be involved.

In addition to the articles of incorporation, you must write a set of corporate bylaws. **Corporate bylaws** are the rules by which a corporation will operate. Items in the bylaws may include how the company will elect directors of the corporation and when stockholders will meet.

When the state approves the application, it issues a corporate charter. A **corporate charter** is a license to operate a corporation. It states the purpose of the business and spells out the laws and guidelines under which the business will operate.

Issuing Stock

The ownership of a corporation is divided into units, which are shares of stock. These shares of stock are bought by people who become known as *stockholders*. Stockholders are the legal owners of the corporation. If you buy even one share of stock in Xerox, for example, you are legally an owner of the company and have all the rights of ownership. Each stockholder receives a stock certificate, which is a document that is proof of ownership. Small corporations usually have only a few stockholders. Larger corporations, such as Kodak and Verizon, have thousands of stockholders.

Closely Held Corporations A closely held, or private, corporation is one whose shares are owned by a relatively small group of people. In many cases, there are only three or four stockholders. The shares are not traded openly in stock markets. Many small and family businesses are organized as closely held corporations.

Publicly Held Corporations A publicly held corporation is one that sells its shares openly in stock markets, where anyone can buy them. Most of these corporations trade their stock on an exchange, such as the New York Stock Exchange or the American Stock Exchange. Almost all major corporations, such as Black & Decker, Intel, and American Express, are publicly held.

Going Public A closely held corporation can be opened to the general public if the stockholders decide in favor of this move. When a corporation decides to sell its stock on the open market, the decision is known as *going public*.



TechByte

Virtual Consultants

Using technology can help you plan your business strategy. Smart software allows you to strategize about how to build your business. For example, the MBA Wizard is intelligent software created with the capacity to learn. It has accurately evaluated over 20,000 business plans, and thus, its expanding knowledge is accessible to the user.



Read more about the MBA Wizard and write a paragraph about how smart software might help an entrepreneur write a business plan through finance07.glencoe.com.

◀ CORPORATE POWER

Corporations produce about 90 percent of all U.S. business revenue. *Why do you think this is the case?*



RELATE

Imagine you and a few friends decide to start a business making and selling cookies decorated to order. What type of business organization would suit you best?

Advantages of the Corporation

What are the benefits of forming a corporation?

Establishing your business as a corporation has a number of advantages over a sole proprietorship and a partnership:

- Ability to raise capital
- Limited liability
- Continued life
- Separation of ownership and management

Ability to Raise Capital

A major advantage of a corporation is the ability to sell its stock and generate capital, or money. If the corporation needs money for growth, expansion, or other purposes, the company can sell additional shares of stock to raise the necessary funds. If a large amount of capital is needed to start a business, the company may begin as a closely held corporation rather than as a partnership. Examples of this kind of corporation might include an automobile dealership, a restaurant, and an amusement park.

Limited Liability

A great advantage to the stockholders, or owners, of a corporation is that they have limited liability. This means that if the corporation has debts or financial problems, the owners may lose only the amount of their investment—the price they paid for their stock.



▲ **WHO OWNS THAT TEAM?** Professional sports teams are operated under all forms of business ownership. Some teams are public corporations. *What would happen if a publicly owned sports team experienced a change in owners?*

Consider the following example: You own \$20,000 worth of stock in the Family Fun Restaurant. The restaurant is not successful and goes out of business while owing \$150,000 dollars to its creditors. As a stockholder, you can lose only up to \$20,000, or the amount of your investment, to help repay these debts. You are not personally responsible for any debt beyond that amount. Unlike a sole proprietorship or a general partnership, a corporation leaves your personal assets protected. You are not legally responsible for all the debts owed by the corporation.

STANDARD
& POOR'S

Global Financial Landscape



Standard and Poor's publishes the globally recognized S&P 500® financial index. It also gathers financial statistics, information, and news, and analyzes this data for international businesses, governments, and individuals to help them guide their financial decisions.

NETHERLANDS

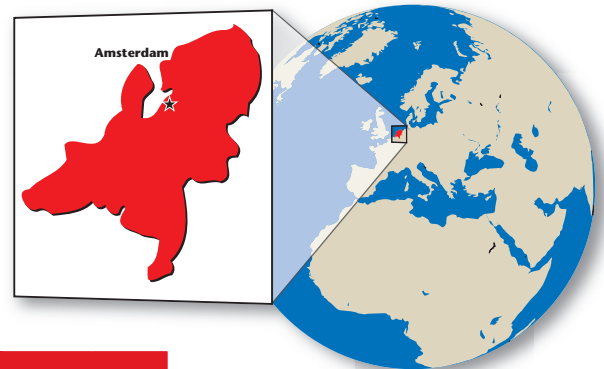
Energy engineers have said that harnessing only 1 percent of the wind's force could produce enough electricity to run the world. By 2020, both the American and European Energy Associations predict that wind will supply 12 percent of the world's power.

The Netherlands is off to a good start. A pioneer of wind energy, the country has granted licenses for the development of wind parks on its coast. The parks will include at least 2,000 turbines, which are the modern-day versions of traditional windmills, familiar sights of the Dutch countryside. To help eliminate polluting fossil-fuel emissions, the Netherlands plans to use these powerful turbines to generate 6,000 megawatts of wind energy. (Nine megawatts can provide



electricity for about 5,000 houses.)

Centuries ago there were as many as 9,000 traditional windmills in the Netherlands. Wind energy was used to pump ocean water away from the Dutch land. Today it can help to light streets and power computers.



STANDARD
& POOR'S

DATABYTES

Capital	Amsterdam
Population	16,237,000
Languages	Dutch and Frisian
Currency	euro
Gross Domestic Product (GDP)	\$461.4 billion (2003 est.)
GDP per capita	\$28,600
Industry:	Agro-industries, metal and engineering products, electrical machinery and equipment, and chemicals
Agriculture:	Grains, potatoes, sugar beets, fruits, and livestock
Exports:	Machinery and equipment, chemicals, fuels, and foodstuffs
Natural Resources:	Natural gas, crude oil, and fertile soil

Think Globally

If a corporation used alternative sources of energy, do you think stockholders might have more or less confidence in the company? Why or why not?



QUESTION

What is the advantage of separating ownership and management?

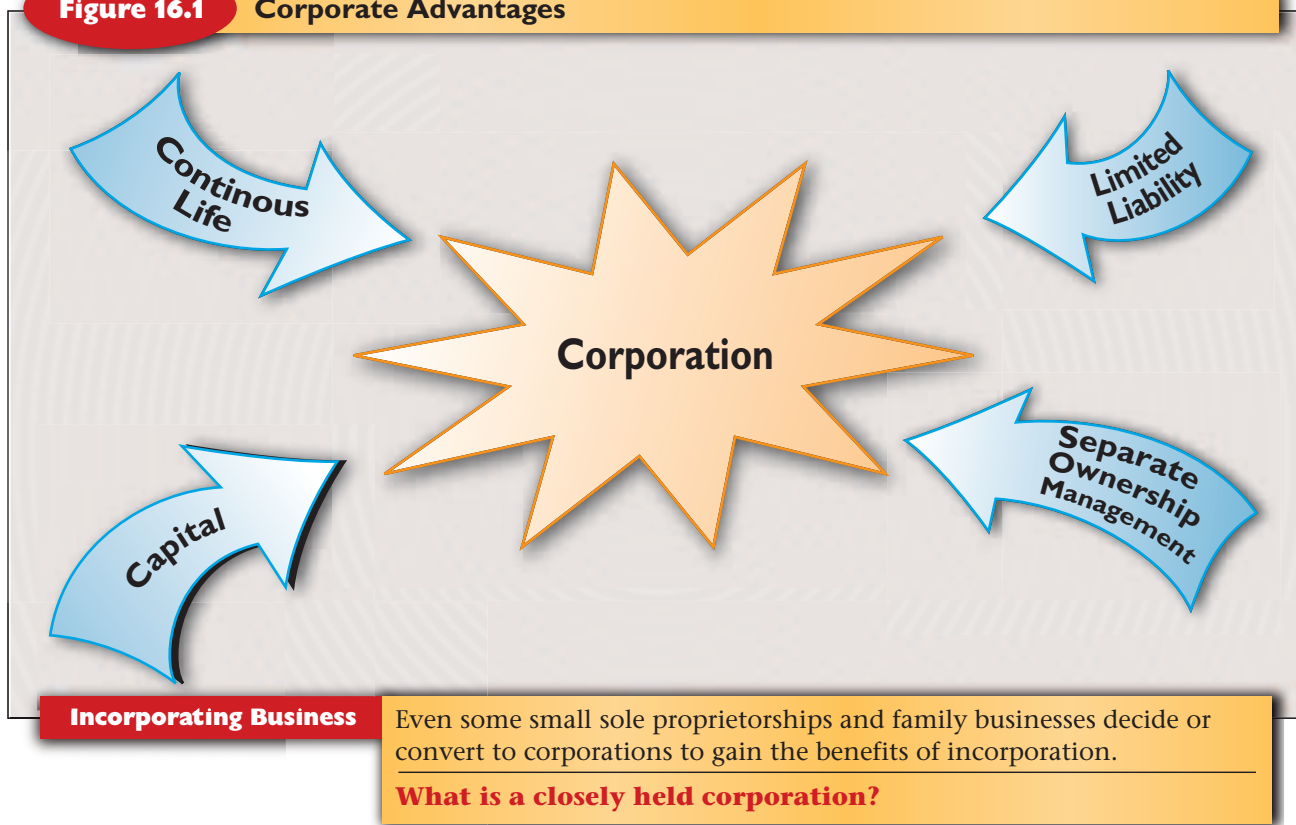
Continued Life

When a sole proprietor retires, dies, or sells his or her business to someone else, that business ceases to exist. Each time partners enter or leave a partnership, a new partnership must be created. In a corporation, however, a change of owners does not end the legal operation of the business. Stockholders may enter or leave at any time without affecting the existence of the corporation. Its legal status as a business continues indefinitely.

Separation of Ownership and Management

The owners do not run the business in most publicly held corporations. Instead, they elect a **board of directors**, a group of individuals who are responsible for overseeing the general affairs of the corporation. Corporate officers and professional managers are hired to make day-to-day decisions in running the business. Other specialists, such as lawyers and accountants, advise the professional managers. By separating management from ownership, the corporation can take advantage of the skills, knowledge, and experience of various individuals to ensure that the business will run successfully. (See **Figure 16.1** for corporate advantages.)

Figure 16.1 Corporate Advantages



In smaller, closely held corporations, the owners often act as the managers who run the business. The separation of ownership and management usually does not occur until a company grows large and goes public. For example, Apple Computer was established originally as a partnership managed and run by its co-owners, Steve Jobs and Steve Wozniak. To expand, they formed a closely held corporation. After it became a publicly held corporation, the company hired professional managers and other specialists to run the business. (See **Figure 16.2** on pages 540–541 for an example of a publicly held corporation as well as other forms of business ownership.)

Disadvantages of a Corporation

What are the drawbacks of corporate ownership?

Though the corporate form of ownership has a number of advantages, it also has several disadvantages:

- Complex and expensive set-up
- Slow decision-making process
- Taxes

Complex and Expensive Set-Up

You have learned that sole proprietorships and partnerships are fairly easy to set up. In contrast, a great deal of work is required to create a corporation. You must complete many forms, file reports, and adhere to many laws and regulations.

As a result of the great amount of work and organization required, forming a corporation costs a large amount of money. Some costs of creating a corporation include legal fees, licensing costs, filing fees, costs of issuing stock certificates, and administrative costs.

Slow Decision-Making Process

A major disadvantage of the corporation is the slowness of the decision-making process. In sole proprietorships and partnerships, only a few people determine how the business is run. As a result, decisions may be made quickly. However, in corporations, especially large ones, many different people study the issues and discuss and debate them before making a decision. The process can take even more time if disagreements occur. Thus, corporations may not respond quickly to issues or situations that affect business.

Taxes

Another major disadvantage of a corporation concerns taxes. Because a corporation is a separate legal entity, it must pay state and federal income taxes on its profits. Dividends that stockholders receive are then taxed again.



Be Your Own Boss

When you are a business owner, you may need to consider incorporating. Learn about the different types of corporations from which to choose and how to incorporate your business.

@ To continue with Task 2 of your WebQuest project, visit finance07.glencoe.com.



Shop by Phone

Instead of driving from store to store, use your telephone to see if a store has the item that you want and compare prices. You will save gas and time. Also, use the Internet to see if the store sells merchandise online. *What type of business ownership might an e-tail store have? What would be the advantage of this type of ownership for the store?*

Perhaps you have wanted to open a business one day that would allow you to combine your love of a sport, interest, or hobby with a business opportunity. This kind of business can take different forms of ownership.

1 Sole Proprietorships

A hobby such as fly-fishing could turn into an ideal *sole proprietorship*. An avid fisherman could offer his or her services as a fishing guide or instructor.



2 Partnerships

Some businesses may be too large for one person to operate. For example, a floral-design business that specializes in events might be a good enterprise for a *partnership* whose owners contribute different talents.





3 Closely Held Corporations Some businesses are organized as *closely held corporations*. The owners could be a group with a common interest, such as kayaking.

4 Publicly Held Corporations Walt Disney World is part of the The Walt Disney Company, a *publicly held corporation* with thousands of stockholders.



MARKETING

Businesses spend billions of dollars on advertising. The most common types of advertising media include newspapers, magazines, direct mail, billboards, television, and radio. *Select two businesses in your community—a sole proprietorship or partnership and a corporation. For each business, find an example of an advertisement for the business. Compile the ads as a class according to the type of media represented. Discuss how each form of business ownership affects the business's choice of advertising media.*

Limited Liability Company

What is another type of ownership?

The federal government also allows another form of business ownership—a **limited liability company (LLC)**, which is a business that operates and pays taxes as a partnership but has limited liability for the owners. It combines some advantages of both the partnership and the corporation. In an LLC, the liability of the owners is limited to their investments. The profits are taxed only once. This form of business is intended for smaller businesses.

Most states allow the creation of LLCs, and they are becoming very popular. The Internal Revenue Service approves of this new form of business organization if the company is small. This form of ownership is not intended for large business operations.

Franchise

Is a franchise a form of business ownership?

A franchise is not a form of business ownership, but it is important to understand its legal status. A **franchise** is a contractual agreement to sell a company's products or services in a designated geographic area. Franchises are very popular in fast-food businesses, such as McDonald's, Subway, Burger King, Wendy's, and Taco Bell, all of which have franchises.

If you start a franchise, you first organize your business as a sole proprietorship, partnership, corporation, or LLC. You then purchase a franchise from a corporation, such as Burger King. This corporation is known as a *parent corporation*. You are now licensed, and the franchise is an asset of your business.



▲ **OWNING A FRANCHISE** Many businesses are franchises. *What are some advantages of purchasing a franchise from a corporation?*

Smaller franchises may cost only a few thousand dollars, but large ones, such as McDonald's and Midas Muffler, cost hundreds of thousands of dollars. The next time you dine under McDonald's golden arches, remember that the establishment is actually a business organized under one of the three forms of business ownership. The business is also a franchise and has paid a franchise fee to McDonald's.

After You Read



REACT

What are four types of business ownership?

Choosing the Form of Ownership

Which form of business ownership is best?

No magic formula exists for deciding which form of ownership is the best. You must carefully consider the advantages and disadvantages of each. Then you can decide which one is best for your particular business and personal needs. Many people feel that a small start-up business is best established as a sole proprietorship or a partnership. These forms of ownership are easy to establish. If the business is successful, you can consider creating a corporation to gain increased capital and limited liability.

Section 16.2 Assessment

QUICK CHECK


1. What are the articles of incorporation, a corporate charter, and corporate bylaws?
2. What is a closely held corporation?
3. What are advantages of a corporation?

THINK CRITICALLY

4. What effect might an increase of stockholders have on a corporation?


USE MATH SKILLS

5. **Issuing Stock** Terrance and several partners own a dry cleaning business that operates as a closely held corporation. They want to go public and sell stock, hoping to raise enough capital to expand the business.

 **Calculate** If the initial offering of their stock sells for \$29.50 per share, how many shares of stock will they have to sell to raise \$1 million?

SOLVE MONEY PROBLEMS

6. **Limited Liability?** Beverly Echo-Hawk is the sole proprietor of All Wet, a raft rental company that operates on the Colorado River. She saved \$35,000 to establish the business. However, competition from other companies with better equipment has caused losses for All Wet. Beverly also owns \$33,000 worth of stock in a corporation that is being managed poorly. She fears that the corporation will go out of business.

 **Analyze** Which investment poses a greater financial risk? Why?

Chapter 16 Review & Activities

CHAPTER SUMMARY

- Sole proprietorships are easy to set up; the owner retains control and profits; there are few government regulations; and profits are taxed once as personal income. The disadvantages include limited capital, unlimited liability, limited human resources, and a limited life.
- In partnerships, general partners have decision-making authority, are active in the business, and have unlimited liability. Limited partners rarely take an active role in the business, and their liability is limited to their investment.
- Partnerships are easy to set up and bring more skills, knowledge, and capital to the business. Partners retain control, and profits are taxed once as personal income. Disadvantages include unlimited liability; potential disagreements; shared profits; and limited life of the business.
- Closely held corporations have shares held by a few individuals, and shares are not traded in stock markets. Publicly held corporations sell shares on stock exchanges, and shares are held by many individuals and institutions.
- To form a corporation, you must file articles of incorporation with the state in which you incorporate, and you must write corporate bylaws. The state issues a corporate charter.
- Corporations operate as legal entities separate from owners and continue no matter who owns them. Corporations issue stock; stockholders have limited liability. However, corporations are difficult and expensive to establish; decision making can be slow; and profits are taxed twice.

Communicating Key Terms

Imagine that you are a lawyer specializing in business law. Use the terms below to explain to a new client the different forms of ownership. Role-play this meeting with a partner.

- sole proprietorship
- partnership agreement
- corporate charter
- Employer Identification Number (EIN)
- general partner
- board of directors
- unlimited liability
- limited partner
- limited liability company (LLC)
- limited life
- corporation
- franchise
- partnership
- articles of incorporation
- corporate bylaws

Reviewing Key Concepts

1. **Explain** why most new businesses begin as sole proprietorships.
2. **Describe** the roles of general and limited partners in a business.
3. **Discuss** the advantage of starting a business as a partnership versus a sole proprietorship.
4. **Identify** the advantages and disadvantages of a closely held versus publicly held corporation.
5. **List** the contents of articles of incorporation.
6. **Explain** why current stockholders might oppose a corporation's decision to issue more stock.



ACADEMIC SKILLS

Geography Three friends who majored in biology together in college want to open up a medical laboratory. They would like to work in a smaller city to service the medical community there.

Research Look at a map of the United States as you search online for growing communities in smaller cities. Pick three possibilities for the new laboratory and choose the best form of business for this group.



YOUR FINANCIAL FIGURES

Initial Public Offerings (IPOs) “Going public” and issuing stock is neither simple nor inexpensive. Go online or use other sources to find out the average cost of an initial public offering. A stockbroker may be able to help you.

- 1. Calculate** If a medium-sized software development company with a current annual net income of \$10 million wants to “go public” and raise \$75 million for growth and expansion, determine the total worth of stock it will have to sell to net this amount.
- 2. Analyze** What factors will be involved in setting the initial stock price?



REAL-WORLD Application


Connect with Economics and Social Studies After being downsized from her job at a corporation, Mia decides to start her own business as a technical writer and editor. Her accountant thinks she should “set up shop” as a limited liability corporation. Mia decides to research this further.

- 1. Research** Investigate the advantages and disadvantages of limited liability companies for someone in Mia’s situation.
- 2. Role-Play** With a partner, take the roles of Mia and her accountant. Prepare a list of questions for Mia to ask and answers for the accountant.



Internet CONNECTION

Running the Show Although many people feel that “being your own boss” is something they really would like to do, not everyone can handle the risks associated with entrepreneurship and sole proprietorship.


 **Log On** Access the Small Business Administration Web site through finance07.glencoe.com and research the personality characteristics an entrepreneur needs to survive and thrive.

Write About It Prepare an article for the school or class newsletter describing these characteristics.



BusinessWeek ONLINE

Newsclip: The New Entrepreneurship There are more entrepreneurs today than there were 20 years ago.

 **Log On** Go to finance07.glencoe.com and open Chapter 16. Learn more about what steps you need to take to build your own enterprise. Write a few sentences about what kind of business you would like to run.

WHAT'S YOUR FINANCIAL ID?

WHAT KIND OF BUSINESS?

You could start a business for virtually any activity. As you take this quiz, use your imagination. Just for fun, review the following list of businesses and choose five that you could imagine owning. Write your answers on a separate sheet of paper.

- _____ a. car repair
- _____ b. photographic studio
- _____ c. veterinary clinic
- _____ d. rock group
- _____ e. gourmet coffee shop
- _____ f. graphic artist studio
- _____ g. newsletter or other publishing enterprise
- _____ h. computer software
- _____ i. biotechnology lab
- _____ j. bed-and-breakfast inn
- _____ k. architectural firm
- _____ l. medical care
- _____ m. hair salon
- _____ n. tutoring service
- _____ o. detective

What do your choices say about you?

- If you selected **b, d, f, g,** or **k,** you are probably artistic. Your strongest interests are in the creative arts or working in a field that requires originality and imagination.
- If you selected **e, j, l, m,** or **n,** you are probably social. You enjoy helping others and working closely with people.
- If you selected **a, c, h, i,** or **o,** you are probably investigative. You like the challenge of making decisions and coming up with innovative solutions.

Were your selections from one category—artistic, social, or investigative—or from a combination of categories? Look to see if you have stronger interests in one area over another. Which types of daily activities do you prefer—artistic, social, or investigative?

Your Financial Portfolio

Setting Up a Partnership

Mary has been teaching yoga classes at a gym for the past three years. She feels she now has enough experience to open her own yoga studio. Since she is concerned about costs and responsibilities, she spoke with one of the other yoga instructors, Tony, about starting a yoga business together. Tony thinks it is a great idea. Together, they outlined their partnership plan:

Location: One of Tony's friends works at an art gallery, which has a peaceful environment and ample floor space. Mary spoke with the owner of the gallery and negotiated using the gallery weekday evenings and Saturday and Sunday mornings. Mary and Tony agreed to pay the gallery owner 25 percent of all class fees.

Competition: The only yoga classes presently being offered in the area are at the health club where they both work.

Start-Up Costs: Mary and Tony must purchase 25 yoga mats at \$20 per mat. They also will have insurance costs of \$1,200 per year, plus \$150 in fees and licenses. They will each contribute an equal amount of money from their personal savings to open the business.

Schedule: They will begin their business with eight classes per week: one each weekday evening, two classes on Saturday morning, and one on Sunday morning. Each class will be one hour in length. They agree that each person will teach four classes a week and cover for the other during illness or vacation.

Responsibilities: Mary is responsible for maintaining accounting records and paying bills. Tony is responsible for advertising and promotion.

Revenue: They decide to charge \$15 per class. They project the weekend classes might bring in 25 students at each class (\$375). Weekday classes might average 5 to 10 students (\$75–150). Mary and Tony agree to share revenue and expenses equally.

Creating the Partnership: To establish a legal partnership, they write a document that outlines the organization of the business, the responsibilities of each partner, and the division of profits and losses.

Analyze

What kind of business would you start with a partner? With another student, choose a business and discuss how you would share responsibilities if you started a partnership together. Ask: What ways might you finance the business? What skills and traits do each of you have that might complement each other in a partnership? On a separate sheet of paper, outline your plan, using Mary and Tony's outline as a model for your business partnership.