Chapter 2 :: Business in our Economy
Section 2.2 ~ Business Ownership

Jump Start

The B&B Bakery continues to grow. Brianna and Brittney want to expand their business and open some new stores. They need to raise additional capital and have decided that the best way to do this is to take on a new partner. A business acquaintance has recommended a good friend, Emilio Torres, who has experience as an accountant and has worked as a legal assistant. After talking with him and learning that he has the funds to invest in their business, they agree to accept him as their partner. They believe that they can work together successfully. They now must decide how they will divide up five management activities among the three partners. What advice do you have for them?

Forms of Business Ownership

In our economy, many thousands of people are business owners. How they run their business is not the same for every owner. Their form of business ownership affects how they operate their business, including how they make decisions, their sources of money, and their control over profits.

Common Forms of Business

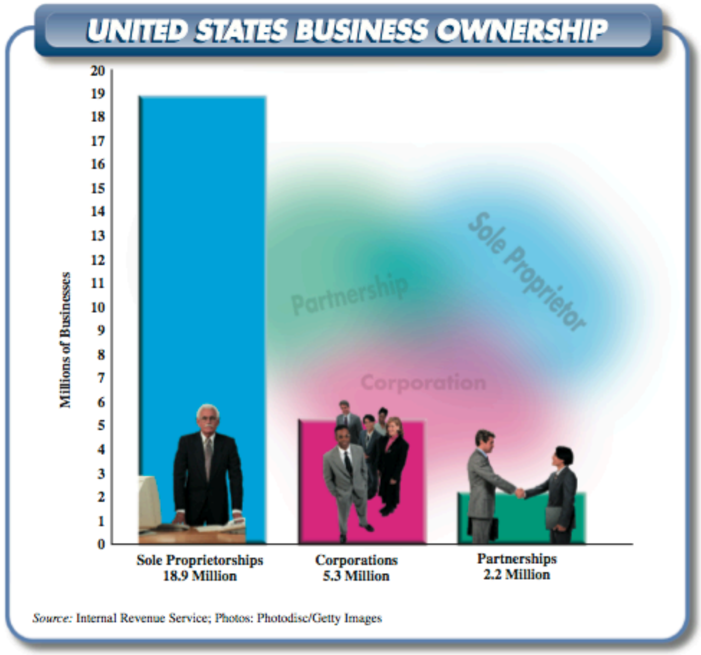
There are three forms of business ownership that are most common in the business world—sole proprietorships, partnerships, and corporations. All three forms have advantages and disadvantages.

Sole Proprietorship A business owned and operated by just one person is called a **sole proprietorship.** Common examples are jewelry stores and restaurants. As the chart above shows, more than 70 percent of businesses in the U.S. economy have been operated as sole proprietorships. A sole proprietorship is the easiest form of business to start and end. There are few legal requirements that need to be met.

The sole proprietor has complete responsibility for all business decisions and management activities. In most cases, the owner also works in the business and may do many or all of the tasks. The sole proprietor keeps the profit but is also personally responsible for all debts of the business. If the business fails, the owner's personal assets may be claimed to pay off debts.

Partnership A business owned and managed by a small group—often not more than two or three people—who have entered into an agreement is called a **partnership.** Partnerships are also quite easy to start, but there will be a written document stating how the partners will share responsibilities. Having business partners often means having more money to invest in the business and more knowledge and expertise to run the business.

Partners may or may not be active in the business. Some partners may be *silent partners,* whose main role is to help finance the operation and give advice in certain areas of the business, while *active partners* run the day-to-day operations. An important part of the written partnership agreement is how profits will be shared. A disadvantage of a partnership is that partners have unlimited *liability,* or legal and financial responsibility, for the debts of the partnership. If the business fails and money is owed, each partner is liable for the entire debt.



Corporation A business owned by a number of people and operated under written permission from the state that charters it is called a **corporation.** This written permission is a legal document called a *certificate of incorporation.* Corporations are more difficult to form than proprietorships and partnerships and face more rules and regulations. Although there are fewer corporations than sole proprietorships, corporations conduct over 70 percent of all business in our economy. Corporations are important to the economy because they usually are large and dominate many markets.

A corporation exists separately from the people who own and operate it. People become owners of the corporation by purchasing shares of stock. These people are *shareholders* or *stockholders.* Shareholders elect a **board of directors,** officers of the company who have the responsibility for directing the business of the company. Most corporations have many owners. Companies such as Kraft Foods, Intel, and Ford Motor Company have millions of owners. At the annual meetings of the board of directors, shareholders usually have one vote per share of stock owned.

An advantage of the corporation form of ownership is that more money can be raised by selling more shares of stock. Also, owners have *limited liability* because their loss is limited to their investment (shares of stock).

A disadvantage of corporations is double taxation. Double taxation occurs because both the corporation's income and the owners' (shareholders) dividends (shares of the corporation's profits) are subject to taxation.

Other Forms of Business

Although most businesses are organized as one of the three common forms of business already discussed, there are other specialized forms of business ownership from which to choose.

Franchises A **franchise** is a written contract granting permission to a businessperson to sell someone else's product or service. The contract spells out the duties and rights of the parties to the contract. The parties to the contract arethe *franchisee,* the business owner who is buying the rights, and the *franchisor,* the parent company that grants the rights. Often included as part of the franchise agreement are the name of the business, the design and color of the building, the location of the business, and the uniforms of the employees. Franchises may be operated as sole proprietorships, partnerships, or corporations.

Franchises are a popular way of doing business. The franchisee maintains the daily operations and receives the profits of the business but must pay a franchise fee along with a percentage of the profits to the franchisor. Successful franchises include KFC, Wild Birds Unlimited, McDonalds, Jiffy Lube, Merry Maids, and Mail Boxes Etc.

Cooperatives A business owned by the members it serves and managed in their interests is called a cooperative. There are two main types of cooperatives. In a *consumers' cooperative,* consumers buy goods and services together at lower prices than each person could buy individually. They also share in the cooperative's profits. A *producers' cooperative,* usually a farm organization, gives the producers greater bargaining power in selling their products and allows them to be more competitive in the marketplace.

A cooperative is much like a corporation. Its formation must be approved by the state. It may sell one or more shares of stock to each of its members. A board of directors may be chosen to direct the business. Profits earned may be refunded to members at the end of the business year. Part of the profit is normally kept for business expansion.

Nonprofit Corporation Corporations that are created for social, political, charitable, educational, or general welfare purposes are known as *nonprofit corporations.* Examples are private colleges and universities and agencies such as the YMCA and the American Red Cross. Nonprofit organizations provide a service, and earning a profit is not their primary goal. They are free from corporate income taxes and can receive grants and donations from individuals and businesses. As with other corporations, they must organize as a corporation, and the government must approve their purpose and operations. Nonprofits file annual reports to the government to maintain their nonprofit status.

You may live in an incorporated town. A *municipal corporation,* or *municipality,* is a nonprofit corporation that can operate much like a city but is not governed under a charter granted by the state. It levies taxes, passes rules and regulations, provides police and fire protection, and provides a variety of services for its citizens. Unlike a business corporation, no stock is issued and revenues are from taxes rather than profits.

Joint Ventures An agreement between two or more companies to share a business project is known as a *joint venture.* It is a type of partnership that includes sharing of profits, as well as sharing of control among the partners. This can include the sharing of raw materials, shipping facilities, management activities, and production facilities.

Manufacturing companies often find joint ventures to be useful. A good example is the joint venture between the Ford Motor Company and the Japanese Mazda Motor Corporation. Mazda produced parts that the Ford Motor Company used in its cars, and Mazda set up assembly plants for Ford Motor vehicles. Joint ventures between Japanese and U.S.

automobile manufacturers have become common.

S Corporations Another type of business, *S corporations,* gets its name from a section of the Internal Revenue Service code. Many small businesses favor this type of corporation. One advantage of the S Corporation is the elimination of double taxation. Under this form of organization, all income is passed through to the owners in the form of dividends and is taxed on their individual tax returns. The corporation's income is not taxed. An S corporation still offers shareholders the limited liability of a corporation, meaning their personal assets are separated from debts incurred by the business.

Limited Liability Company A kind of corporation that is worldwide, but relatively new in the United States, is a limited liability company (LLC). LLCs are allowed by state statutes and first appeared in the United States in 1977. By 1996, nearly all states had enacted a statute allowing the existence of LLCs. A national Uniform Limited Liability Company Act was adopted in 1996 and was revised in 2006.

A limited liability company (LLC) combines the best features of a corporation and a partnership. It provides liability protection for the owners but does not require a complex set of organizational and operating requirements such as those needed for a corporation. A simple set is all that is needed. Articles of incorporation or bylaws also are not required. Only a simple document, much like a partnership agreement, needs to be developed.

Manage a Successful Business

For a business to be successful, someone must plan, organize, staff, lead, and control its operations. Managers are responsible for performing or coordinating those activities. In a small business, the owner often performs all of these activities.

Plan

The process of thinking, gathering, and analyzing information, as well as making decisions about all phases of the business, is called *planning.* Goals and standards are set for the business, and strategies and measurements are established for achieving them. Some managers spend too much time on day- to-day operations and fail to spend enough time on planning. That is a problem in many businesses, but especially in sole proprietorships.

Organize

The process of determining what work has to be done and who is to do it is called *organizing.* An important part of organizing is assigning work to employees and observing employees as they perform their jobs. Responsibility is given to certain people to see that jobs are done correctly. In large businesses, *organization charts* are often drawn up to show worker relationships and lines of authority and responsibility.

Staff

Staffing includes the many activities involved in finding, selecting, hiring, training, evaluating, and rewarding employees. There are many laws and regulations regarding employees' rights that must be known and followed by all sizes of businesses. For example, the person responsible for interviewing potential employees must be aware of what can and cannot be asked in the interview. Employment agencies can be helpful in assisting small business owners in locating potential employees.

Lead

It is important that employees are directed in their work so that they perform their tasks correctly and in a timely manner. This activity is called *leading.* People should be guided to perform according to plans and procedures of the business so that the work that they do is productive. Effective leaders can inspire workers to perform work tasks efficiently and accept personal responsibility for achieving goals of the company. Good leaders make sure that their workers are recognized and rewarded for excellence.

Control

When managers or supervisors compare what has been accomplished with what was planned, they are engaging in the process known as *control.* This involves determining whether or not operations are proceeding as planned. Standards are set up in the planning stage, and measurements are determined to track whether or not the standards are met. For instance, a business might set a standard for employees to handle 12 customer-inquiry calls per hour. The control factor would be to know the actual number of calls handled per hour by each worker. Control is directly related to planning.

Think Critically

1. Why do you think there are so many sole proprietorships in the U.S. economy?
2. What are some of the advantages of operating a business as a franchise rather than just going into business on your own?
3. Which of the five key management activities do you think would be the most challenging for you to perform? Why?
4. How are the business activities of controlling and planning related?