chapter 6

Forms of Business Ownership

Better Business

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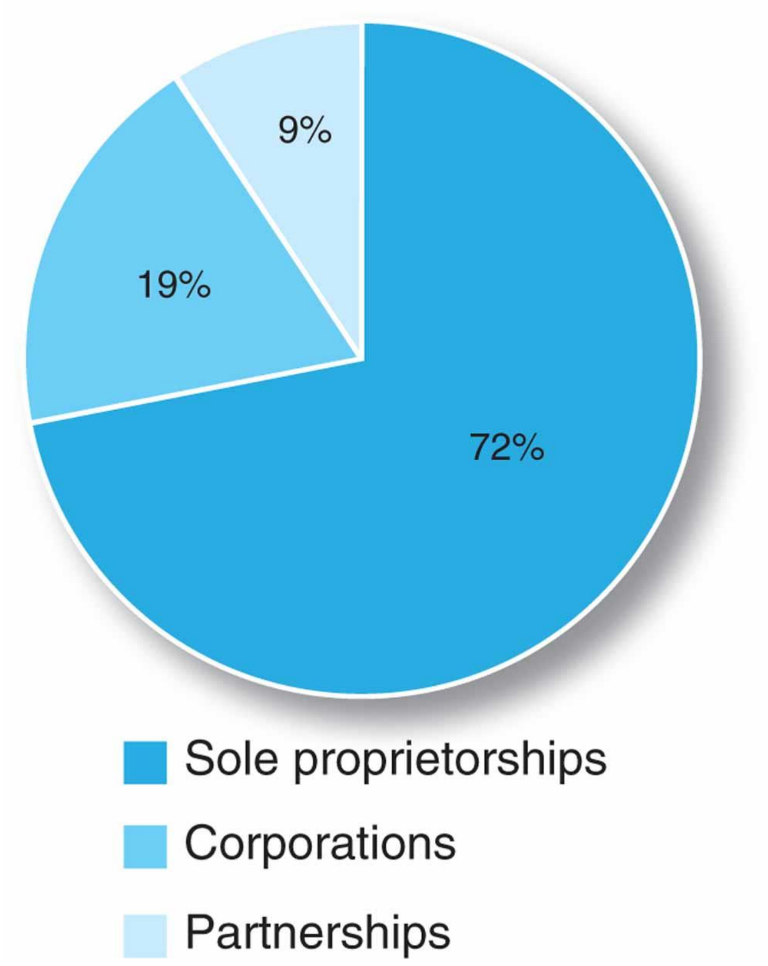
Businesses by Type of Ownership



Sole Proprietorship

Characteristics of a Sole Proprietorship	
Characteristics	**Sole Proprietorship**
Preliminary paperwork	No special forms; no state or federal filing requirements
Period of existence	Proprietorship terminated when sole proprietor dies or ends business
Liability	Sole proprietor has unlimited liability
Operational requirements	Minimal legal requirements
Management	Sole proprietor has full control of management and operations
Taxation	Not a separate taxable entity; taxes paid through sole proprietor's personal returns
Reporting of income/loss	Income/loss reported on owner's personal income taxes
Raising capital	Outside sources of income difficult to raise; funding usually comes from owner contributions

Sole Proprietorship

Advantages	Disadvantages
• Ease of formation • Greater control and flexibility • No specific corporate records to keep or file • Potential financial/tax benefit of combined business and personal finances	• Unlimited liability • Potential difficulty in borrowing money

Partnership

Characteristics of a Partnership	
Characteristics	**General Partnership**
Preliminary paperwork	No special forms required for state or federal filings; partnership agreement recommended
Period of existence	Partnership terminated upon death or withdrawal of a partner unless otherwise provided for in the partnership agreement
Liability	Partners have unlimited liability
Operational requirements	Minimal legal requirements
Management	Partnership agreement should specify management roles, though generally each partner has an equal voice
Taxation	Not a taxable entity; income flows through individual partner's tax returns, and each partner pays tax on his or her share of income; losses can be deducted against other sources of income
Reporting of income/loss	Income/loss reported on partners' personal income taxes
Raising capital	Capital primarily raised through partner contributions; additional raised as partners are added

Partnership

Advantages	Disadvantages
• More owners contribute capital • Greater ability to increase sales, market the business, and generate income • Shared financial responsibility • Partners likely willing to work very hard • Utilize complementary skills • "Two heads are better than one"	• Need the "right" partner • Must share control—and profits • Difference in opinion on company's direction

Sole Proprietorship vs. Partnership

Similarities	Differences
• Inexpensive to set up • Unlimited liability • Financials flow through individual's tax returns • No tax benefits • Legally dissolves upon change or death of owner or partner • Profits increase owner's personal taxes	• Number of people contributing resources • Sharing of profits and liabilities • Ability to get financing

Partnership Agreement

- Capital contributions
- Responsibilities of each partner
- Decision-making process
- Shares of profits or losses
- Departure of partners
- Addition of partners

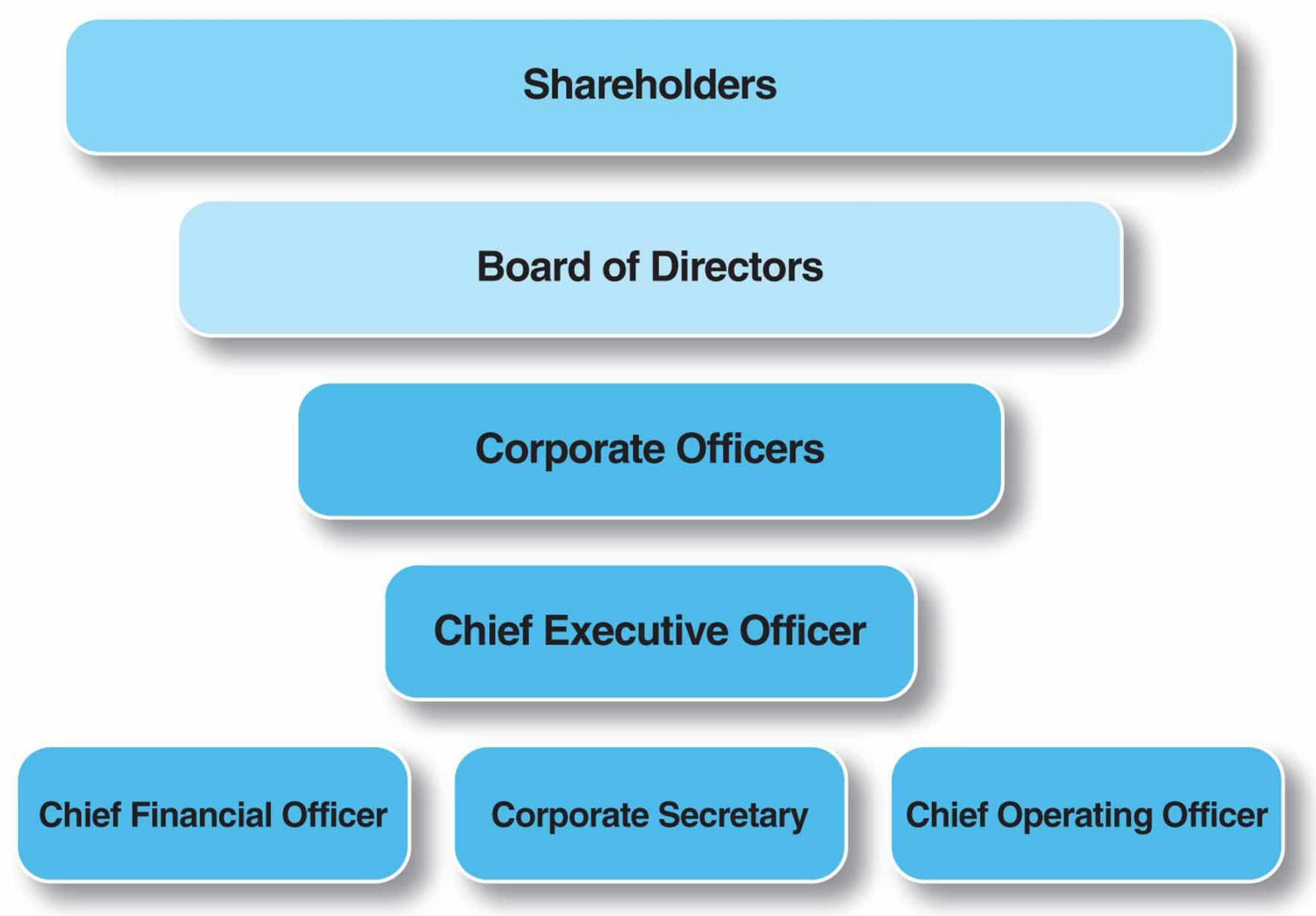
Types of Partnerships

- General partnerships
  - Default arrangement
  - Simplest to form
- Limited partnership
  - General partners
  - Limited partners

Corporations

Characteristics of a C Corporation	
Characteristics	**C Corporation**
Preliminary paperwork	Paperwork required to file with both state and federal agencies
Period of existence	Corporations are separate entities; existence is not dependent on founders, owners, or partners; shares of stock are easily transferred
Liability	Shareholders are usually not personally liable for the debts of the corporation
Operational requirements	Must have a board of directors, corporate officers, annual meetings, and annual reporting
Management	Shareholders elect the board of directors that provides the global management of the corporation
Taxation	Taxed at the entity level; if dividends are distributed to shareholders, dividends are also taxed at the individual level (double taxation)
Reporting of income/loss	Corporations are separate entities; no income or loss reported on shareholder’s tax statements
Raising capital	Capital raised through sale of shares of stock

Corporate Structure



Corporations

Advantages	Disadvantages
• Separated liability • Extended life and ownership transfer • Raising capital • Corporate benefits • Tax benefits	• Must file an annual report • Must maintain minutes of key meetings • Must follow corporate financial and tax rules • Double taxation

S Corporation

- A regular (C) corporation that has elected to be taxed under a section of the Internal Revenue Service code called Subchapter S

Advantages	Disadvantages
• Taxed like a partnership, not corporation • Limited liability	• Restrictions on whether a company can be an S Corporation

Limited Liability Company (LLC)

- An LLC combines corporate limited liability with partnership tax advantages with fewer administrative requirements than S or C corporations
- Often used by professional corporations formed by accountants, attorneys, and doctors

Comparing C and S Corporations and LLCs

	Common (C)	Subchapter S (S)	Limited-Liability Company (LLC)
Ownership	unrestricted	restricted	unrestricted
Subsidiaries	allowed	Not allowed	allowed
Perpetual life	yes	yes	no
Stock transferable	yes	yes	With approval
Self-employment taxes	none	On compensation only	On all profits
Profit and loss distribution	At the discretion of the board of directors	Proportional to shareholder's investment	As owners decide
Owner and employee benefits	May offer benefits and stock options	May offer benefits and stock options	Limited in benefits can offer; no stock benefits

Not-for-Profit Corporations

- An incorporated business that does not seek a net profit
- Utilizes revenue available after normal operating expenses for the corporation's declared social or educational goals
  - Revenues come primarily from fundraising and donations
- Tax-exempt with 501(c)(3) status

Cooperative

- A business that is owned and governed by members who use its products or services
- Provides services to people with common interests
- Members can be individuals or businesses
- Members set policy and elect directors
- Biggest advantage is group power

Mergers and Acquisitions

- Merger
  - Two companies join to form one company
  - Friendly and mutually agreed upon
- Acquisition
  - One company takes over another company
  - Unfriendly acquisition
    - Hostile takeover
    - Tender offer
    - Proxy fight

Why Do Mergers and Acquisitions Occur?

Generally,

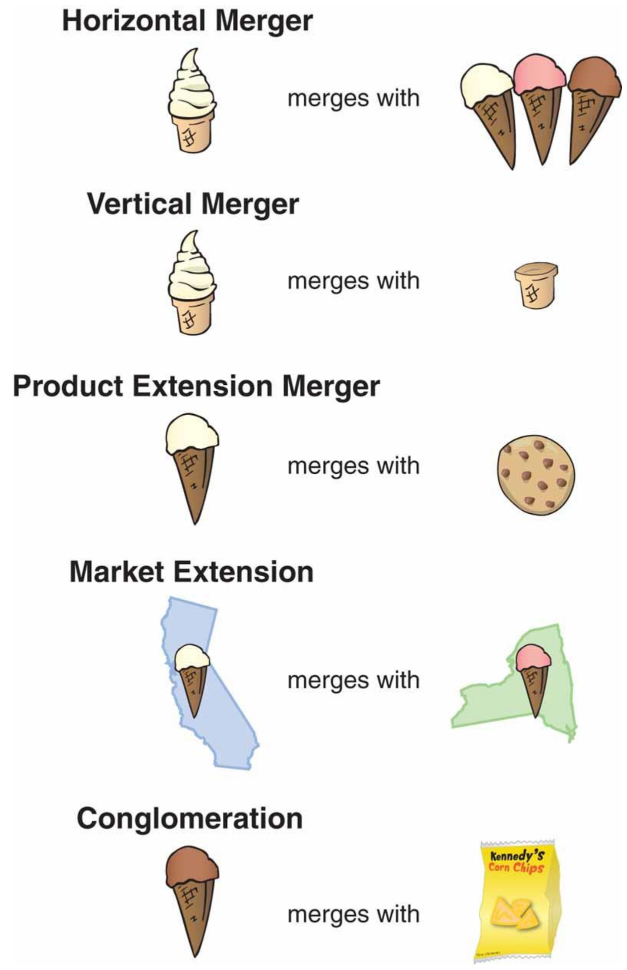
- To increase competitive advantage
- To gain synergy

Specifically,

- To become the dominant force in the market
- To reduce costs
- To add new product lines
- To expand into new geographic areas
- To gain innovations

"Are you thinking what I'm thinking?"

Types of Mergers



Disadvantages of Mergers

- Nearly two-thirds don't achieve greater market value
- Revenues and profits suffer because day-to-day activities are neglected while the companies are combined
- Corporate cultures may clash
- Communications may break down
- New division of responsibilities can be vague
- Divided loyalties, hidden agendas, or power struggles within new management team may lead to conflict
- Employees may be nervous as jobs are usually eliminated
- Employees whose jobs aren't threatened may still leave

Chapter Summary

1. What are the strengths and weaknesses of a **sole proprietorship**?
2. What are the advantages and disadvantages of a **partnership** and a **partnership agreement**?
3. How is a **corporation** formed, and how does it compare with sole proprietorships and partnerships?
4. What are the major differences between a **C corporation**, an **S corporation**, and an **LLC**?
5. What are the characteristics of **not-for-profit corporations** and **cooperatives**?
6. What are the different types of **mergers** and **acquisitions** and why do they occur?

Beyond the Book

Board of Directors Responsibilities

- The board is responsible for the corporation
  - Directors must be truly independent
  - New requirements for audit, nomination, and compensation committees
    - At least one audit committee member must be a financial expert
  - Loans to executives and directors banned
- SEC has more power to bar a director
- Possible criminal charges for fraud and negligence
- Requirements created or strengthened by Sarbanes-Oxley Act of 2002

Why Be on a Board of Directors?

- Even with the added scrutiny of boards today, being a director is still enticing for:
  - Financial rewards
  - Perks
  - Professional development
  - Networking
  - Recognition

Largest U.S. Private Companies

Firm	Industry	Employees	Revenue
Koch Industries	diversified manufacturer	80,000	$100 billion
U.S. Postal Service	courier	596,000	$68 billion
Cargill	food producer	160,000	$120 billion
Chrysler LLC	automotive	58,000	$45 (projected)
Kaiser Permanente	health care	181,900	$34.4

How Ethical Is Your Nonprofit Organization?

- The nonprofit world has a guiding principle: No one individual is to profit from the organization
- Nonprofit ethics:
  - Honesty
  - Openness and transparency
  - Conflicts of interest
  - Privacy
  - Fundraising issues
  - Treating employees, volunteers, and clients with respect
- Examples of non-profits that have had ethical issues
  - Nature Conservancy
  - Red Cross

InBev’s Acquisition of Anheuser-Busch

Date (2008)	Event
May 23	Rumors of InBev’s potential acquisition of Anheuser-Busch heat up
June 11	Anheuser-Busch confirms they received an unsolicited $46.3B takeover bid from InBev
June 20	Anheuser-Busch rejects InBev’s $65 per share offer as "financially inadequate”
July 7	InBev threatens to replace Anheuser-Busch board of directors
July 8	Anheuser-Busch states it is “open to higher offer from InBev”
July 13	Anheuser-Busch and InBev agree to “merge.” Shareholders to receive $70 per share.

Mars Buys Wrigley

- Mars and Berkshire Hathaway bought Wrigley for $23 billion in April 2008
  - Bill Wrigley and other executives remain
- Synergies
  - Both have global power brands such as M&Ms, Snickers, Extra, and Orbit gum
  - Marketing and distribution savings including Mars's global distribution network
  - Gum has higher growth rates than chocolate
  - Little product overlap
  - Together will have 14% of the global market