

ACTIVITY 1

TYPES OF BUSINESS ORGANIZATIONS

Sole Proprietorship

A sole proprietorship is a business with one owner, and is relatively easy to form. The owner has unlimited liability for all debts of the business, which means that personal assets of the proprietor can be used to repay any losses incurred by the business. The profit or loss from the business is entirely owned by the proprietor and is reported on the entrepreneur's personal income tax return, along with all other income and expenses. The life of a sole proprietorship is limited to the time that the owner is able to operate the business.

A sole proprietorship may be a very small business with one owner/employee, it may have only a few employees, or it may be a very large business with hundreds of employees. All business decisions, whether good or bad, are the responsibility of the entrepreneur. While a sole proprietor may not need to follow as many government regulations, as with other structures, he or she absolutely must be diligent about keeping accurate tax and employee records and following employment laws.

Sole proprietors commonly put in long hours of work. They may have difficulty raising capital from outside sources for their business if others are leery about taking on the risk. Many sole proprietors use their personal savings and investments in order to make their business successful. The sole proprietor bears all the financial risks.

Partnership

Partnerships can take two forms: general partnership and limited partnership. A general partnership is similar to that of a sole proprietorship in several ways. It is relatively easy to form, the income generated from the partnership is only taxed once (declared on each partner's individual tax return), and the partners have unlimited liability, which means that creditors can take personal assets of the partners if the partnership does not have enough money to pay the bills. The life of a partnership is also limited to the time that the partners are working together in the business. As soon as one partner leaves the partnership, a new partnership is created by the remaining partners. If there are only two partners and one wishes to leave, the remaining partner has the opportunity to operate the business as a sole proprietorship once all the legal ramifications have been finalized.

Partnerships have several differences from sole proprietorships. First, partners can secure financing more easily because more than one person is able to obtain credit. Second, partnerships often involve people with complementary skills, meaning that one partner is responsible for some aspects of a business (such as sales) while the second partner is responsible for other areas (such as production).

A business partnership is like a marriage, in that both partners need to work well together, take on responsibility with great integrity, and have good decision-making skills. To ensure success, the partnership should have a carefully worded Articles of Partnership document that clearly lays out what each partner is responsible for doing, how the profits are distributed, and the percentage of the company each partner owns. There have been many failed partnerships that have left one individual liable for the poor economic decisions or unethical behavior of the other partner. And since unlimited liability in a partnership means that any partner is liable for the expenses of the whole enterprise, if one partner cannot pay his or her share of the losses, the other(s) are responsible.

In a limited partnership, the limited partner is responsible only for the contribution he or she has made to the partnership, and the other general partners have unlimited liability for the remaining debts. Many people will become a limited partner in a partnership because it is less risky. With certain minor exceptions, tax reporting is the same as for a general partnership.

ACTIVITY 1, CONTINUED

TYPES OF BUSINESS ORGANIZATIONS

Corporation

A corporation is more complicated than that of a sole proprietorship or partnership. The services of an attorney are required to file a document called the Articles of Incorporation, which are then sent to the Secretary of State's Office in that company's home state. The Articles of Incorporation detail the purpose of the business as well as other information, such as how many stocks will be issued and who will initially be involved in running the business. When the state gives approval for the establishment of a corporation, the state has created a new legal entity. It operates the same as an individual adult who pays taxes and must abide by certain laws.

Corporations must follow much stricter regulations (both state and federal) than sole proprietorships or partnerships do. The corporation must issue stock, and those who buy the stocks become part owners of the corporation. A corporation provides limited liability for its investors, which means that none of the stockholders is obligated to cover the debts of the corporation beyond what he or she has invested in the company. Because of the limited liability provision, corporations generally have an easier time raising capital from investors than do sole proprietorships and partnerships. And unlike the sole proprietorship and partnership, the corporation, has an unlimited life span as ownership, reflected through stocks, can be readily traded or passed on from one generation to another.

The corporation files its own tax return and pays taxes on its income. If the corporation distributes some of its earnings in the form of dividends, then the stockholders must pay taxes on those dividends, even though the corporation has paid taxes on its earnings. This is why it is said that corporate income is double-taxed.

Each corporation has a board of directors, made up of a group of individuals who meet during the year to make important decisions about the company. Stockholders elect the board members, who oversee the overall operations of business. The board also elects and monitors the officers of the company. These are the individuals who are responsible for the day-to-day operations of the business. Typically, many owners (stockholders) do not work in, or for, the business.

A corporation can be a privately or publicly held. A public company or publicly traded company is a company that offers its securities (stock, bonds, etc.), for sale to the general public, typically through a stock exchange. Privately held companies or closed corporations are owned by a relatively small number of shareholders who own stocks which are not traded publicly. Many family-owned corporations are privately held companies, where the family members own all of the stocks. When a member wants to sell his or her shares, another family member usually buys them.

Many individuals and partners choose to create what is called an "S"-corporation. An S-corporation is treated as a partnership and not as a corporation for tax purposes, meaning that the corporation itself does not pay federal income tax. Instead, the partners include their share of the corporation's income losses in their own personal tax returns, which can afford them certain tax breaks. An S-corporation is treated as a regular corporation for other purposes, and requires Articles of Incorporation. S-corporations must follow the same formalities and record keeping of a corporation. S-corporations are also managed by a board of directors and officers, however, the board and officers are typically the partners of the business.

ACTIVITY 1, CONTINUED

TYPES OF BUSINESS ORGANIZATIONS

Franchise

A franchise is actually a hybrid, and can take the form of a sole proprietorship, partnership or corporation, depending upon the legal formation. Franchising offers the advantages of a quick startup, a proven business plan, recognizable trademark and brand, and a pre-existing infrastructure. For many, a franchise is merely a temporary business investment opportunity without the hassles of long-term ownership.

A franchise usually lasts for a fixed time period and serves a specific "territory" or area surrounding its location. A franchisee may manage or own several such locations. Agreements typically last from five to 30 years. If a franchisee wishes to terminate his or her contract with the franchisor (the seller of the franchise), the franchisee may face serious consequences. Franchise contracts tend to favor the franchisor. For example, franchisors are usually protected from lawsuits from their franchisee, and contracts are renewable at the sole option of the franchisor. Most franchisors require franchisees to sign agreements that waive their rights under federal and state law. Fees are fully disclosed up front, and start-up costs and working capital must be in place before an individual or partnership can secure the license. In addition, the franchisor will be required to pay a royalty fee for the use of the trademark, and a reimbursement fee for training and advisory services. Depending upon the franchise, royalty fees (a percentage of the gross profits) are paid to the franchisor on a weekly or monthly basis, while the reimbursement fee is usually paid up front before any training begins.

The franchisee must carefully negotiate a license called a "Document Disclosure." The franchisees, along with the franchisor, develop both marketing and business plans, usually with the help of a territory manager. For the franchisee to be successful, there must be assurance that any future franchises do not crowd the territory. The franchisee must be seen as an independent merchant, and must be protected by the franchisor from any trademark infringement by third parties.

ACTIVITY 1, CONTINUED

TYPES OF BUSINESS ORGANIZATIONS

Type of ownership: _____

Advantages (Benefits)	Disadvantages (Costs)
<ul style="list-style-type: none">•••••••••••	<ul style="list-style-type: none">•••••••••••

ACTIVITY 2**THE CONCENTRATION GAME**

All Decisions Yours (1)	Sole Proprietor (2)	Articles of Partnership (3)	Use of a Proven Idea (4)	Disclosure Statement (5)
Brand Name (6)	Low Start-Up Costs (7)	Divided Authority (8)	Perpetual Existence (9)	Franchise (10)
Board of Directors (11)	Unlimited Liability (12)	Limited Government Regulations (13)	Royalty Fees (14)	Charter (15)
Exclusive Rights (16)	Divided Responsibility (17)	Long Hours (18)	Stockholders (19)	Limited Liability (20)
Number of Restrictions (21)	Greater Freedom (22)	Partnership (23)	Divided Profits (24)	Very Little Government Regulation (25)
Easy to Form (26)	Double Taxation (27)	Reimbursement for Training/Advising (28)	Accurate Record keeping (29)	Corporation (30)

ACTIVITY 3**WHAT BUSINESS STRUCTURE SHOULD WE ADOPT?**

- A. Justin, Austin, and Mattaio have been close friends since high school, and even went to college together. All three boys graduated last year; Justin with a degree in Computer Science, Austin with a degree in Graphic Design, and Mattaio with a degree in Business Administration. All three are “computer geeks” and have worked part-time through high school and college fixing computer problems. Each has approximately \$50,000 in savings for this business venture. They have been talking about starting a computer company (JAM Computer Solutions) in their local town to help businesses and individuals with computer problems or those who need help developing and designing web sites. In doing research, Justin found that there are only two other computer companies in their town of 100,000 people, and neither one will do both web design and computer hardware/software troubleshooting.
- B. Marlin Hatfield, who is married and 27, just completed his fifth year as a journeyman carpenter with John Casey Homebuilders, a small homebuilder 25 miles from his hometown. Marlin has just received an inheritance of \$100,000 from his favorite aunt. During the past five years, Marlin has been able to purchase many of the tools and equipment that he needs to be a good finish carpenter. He has not been satisfied working for John the past couple of years and has talked with his wife about starting his own business (M and K Fine Carpentry). Marlin’s wife, Katherine, agrees that in order to be happy, Marlin may want to open his own business. She fully supports Marlin. Katherine graduated from the local university with a degree in accounting and works for a local accounting firm.
- C. Demitri and Roland have decided to combine their talents and open a competitive Cheer and Dance business. Demitri’s expertise is the business side. He has a degree in Business Administration with a minor in Entrepreneurship; while Roland has a degree in Sports Management and has been coaching the local high school cheerleading team, while his wife has been coaching the school’s dance team. The problem is that Roland does not have as much capital to invest. In fact, they are having a little trouble figuring out how they will be able to get the startup capital for the business. Some of their friends/relatives might be willing to invest in the firm. There are no other competitive Cheer and Dance companies in the area. They have found a building to lease at \$4,000 per month and expect that utilities and water will cost approximately \$350 per month. Liability insurance has been estimated to be \$1,000 per month, due to possible injuries. Demitri, Roland and Roland’s wife will do all the coaching and will also do all the paper work.
- D. Craig and Carol knew that they wanted more out of life. Craig works as an inspector for the city health department, which involves inspecting restaurants and food service establishments to see whether they are operating according to local laws. Carol worked as an insurance agent for the first 10 years of their marriage and is a stay-at-home mom. Their home is paid for and their oldest daughter received scholarships to attend their local state university. Their son Charles is a senior in high school. Neither Craig nor Carol has much experience in owning or operating a small business, yet this is what they want to do when their son graduates from high school. They have been frugal and have saved over \$200,000 for this venture. Craig will not be quitting his job for a while. This will leave Carol with the responsibility of running the business.

ACTIVITY 3, CONTINUED

WHAT BUSINESS STRUCTURE SHOULD WE ADOPT?

Questions:

Which scenario did your group read?

Which business organization would you choose?

What are the advantages of this choice?

What are the disadvantages of this choice?

ACTIVITY 4

BUSINESS ORGANIZATIONS IN THE U.S. ECONOMY

Table 744. Number of Tax Returns, Receipts, and Net Income by Type of Business

[5,770 represents 5,770,000. Covers active enterprises only. Figures are estimates based on sample of unaudited tax returns; see Appendix III]

Item	Number of returns (1,000)			Business receipts ² (billion dollars)			Net income (less loss) ³ (billion dollars)		
	Nonfarm proprietorships ¹	Partnerships	Corporations	Nonfarm proprietorships ¹	Partnerships	Corporations	Nonfarm proprietorships ¹	Partnerships	Corporations
1970	5,770	936	1,665	199	92	1,706	31	10	66
1975	7,221	1,073	2,024	274	146	3,120	40	8	143
1980	8,932	1,380	2,711	411	286	6,172	55	8	239
1984	11,262	1,644	3,171	515	358	7,551	71	-4	233
1985	11,929	1,714	3,277	540	349	8,050	79	-9	240
1986	12,394	1,703	3,429	559	379	8,282	90	-17	270
1987	13,091	1,648	3,612	611	428	9,186	106	-5	328
1988	13,679	1,654	3,563	672	516	9,804	126	15	413
1989	14,298	1,635	3,628	693	524	10,440	133	14	389
1990	14,783	1,554	3,717	731	541	10,914	141	17	371
1991	15,181	1,515	3,803	713	539	10,963	142	21	345
1992	15,495	1,485	3,869	737	571	11,272	154	43	402
1993	15,848	1,468	3,965	757	627	11,814	156	67	498
1994	16,154	1,494	4,342	791	732	12,858	167	82	577
1995	16,424	1,581	4,474	807	854	13,969	169	107	714
1996	16,955	1,654	4,631	843	1,042	14,890	177	145	806
1997	17,176	1,759	4,710	870	1,297	15,890	187	168	915
1998	17,409	1,855	4,849	918	1,534	16,543	202	187	838
1999	17,576	1,937	4,936	969	1,829	18,009	208	228	929
2000	17,905	2,058	5,045	1,021	2,316	19,593	215	269	928
2001	18,338	2,132	5,136	1,017	2,569	19,308	217	276	604
2002	18,926	2,242	5,267	1,030	2,669	18,849	221	271	564
2003	19,710	2,375	5,401	1,050	2,818	19,755	230	301	780
2004	20,591	2,547	5,558	1,140	3,142	21,717	248	385	1,112
2005	21,468	2,764	5,671	1,223	3,719	24,060	270	546	1,949
2006	22,075	2,947	5,841	1,278	4,131	26,070	278	667	1,933
2007	23,122	3,098	5,869	1,324	4,541	27,335	281	683	1,837
2008	22,614	3,146	5,847	1,317	4,963	27,266	265	458	984

FOOTNOTES:

¹ In 1980, represents individually-owned businesses, including farms; thereafter, represents only nonfarm proprietors, i.e., business owners.

² Excludes investment income except for partnerships and corporations in finance, insurance, and real estate before 1998. Beginning 1998, finance and insurance, real estate, and management of companies included investment income for partnerships and corporations. Starting 1985, investment income no longer included for S corporations (represents certain small corporations with up to 75 shareholders (35 for 1990 and 1995), mostly individuals, electing to be taxed at the shareholder level).

³ Net income (less loss) is defined differently by form of organization, basically as follows: (a) Proprietorships: Total taxable receipts less total business deductions, including cost of sales and operations, depletion, and certain capital expensing, excluding charitable contributions and owners' salaries; (b) Partnerships: Total taxable receipts (including investment income except capital gains) less deductions, including cost of sales and operations and certain payments to partners, excluding charitable contributions, oil and gas depletion, and certain capital expensing; (c) Corporations: Total taxable receipts (including investment income, capital gains, and income from foreign subsidiaries deemed received for tax purposes, except for S corporations beginning 1985) less business deductions, including cost of sales and operations, depletion, certain capital expensing, and officers' compensation excluding S corporation charitable contributions and investment expenses starting 1985; net income is before income tax.

Source: U.S. Internal Revenue Service, Statistics of Income, various publications.

a. What is the total number of ownerships reported in 2008? _____

ACTIVITY 4, CONTINUED**BUSINESS ORGANIZATIONS IN THE U.S. ECONOMY**

- b. Of that number, what percent were

Sole proprietorships: _____

Partnerships: _____

Corporations: _____

- c. Why do you think there are so many more sole proprietorships than corporations?

- d. What was the total number of businesses owned in 1970? _____

- e. Of that number, what percent were

Sole proprietorships: _____

Partnerships: _____

Corporations: _____

- f. Between 1970 and 2008, by how many businesses did each business type increase?

Sole proprietorships: _____

Partnerships: _____

Corporations: _____

- g. What was the percentage increase from 1970 to 2008 for each type of business organization?

Sole proprietorships: _____

Partnerships: _____

Corporations: _____

- h. What was the total percentage increase in business ownerships from 1970 to 2008?

- i. In which years did the business receipts for each form of business ownership NOT increase?

Sole Proprietorships: _____

Partnerships: _____

Corporations: _____

ACTIVITY 4, CONTINUED

BUSINESS ORGANIZATIONS IN THE U.S. ECONOMY

- j. Are there any years when any of the types of businesses had a loss? _____
- k. What might be one reason businesses still made a profit even when their business receipts declined? For example why didn't sole proprietorship profits decrease in 1991 since their revenues declined? _____

- l. In 2008, what was the average net income for a sole proprietor? _____
- m. In 2008, what was the average net income for a corporation? _____
- n. Why do you believe the average income from a corporation is higher than a sole proprietorship? What does this indicate about the average size of the sole proprietorship when compared to the average corporation? _____

- o. Read the last statement in the footnote of section 3, Part C, concerning the net income of a corporation. Would the actual net income of all corporations be more or less than this amount? Why is it said that the income from a corporation is double-taxed? _____

- p. In 2008, approximately how many sole proprietorships were there in the United States compared to corporations? How do the profits of all corporations compare to the profits of all sole proprietorships in the same year? Put your answer for both questions in percentage terms.

ACTIVITY 5**RESEARCHING A LOCAL FRANCHISE**

1. Name of company _____
2. Location of parent company

3. Founder of parent company _____
4. Year company was founded

5. Current President/CEO of parent company

6. What are the initial startup costs? _____
7. How many franchises are located in your City _____ State _____ Nation _____ World _____
8. What are the royalty fees associated with this franchise? _____
9. How often are royalty fees paid? _____
10. What is the cost for a building/lease? _____
11. What is the cost for equipment? _____
12. What is the cost for supplies? _____
13. What is the franchisee net worth requirement (total assets – total liabilities)?

14. What is the franchisee liquidity requirement? (Total amount of cash in checking/savings/stocks,

ACTIVITY 5, CONTINUED

RESEARCHING A LOCAL FRANCHISE

etc.)

15. Are there any prescribed vendors? _____

16. How many employees are required to operate the business? _____

17. Are there fees for national and local advertising? _____

18. Are you allowed to advertise locally? _____

19. Other Historical information.
