PART 2

Business Ownership and Entrepreneurship

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In Part 2 of *Business,* we look at a very practical aspect of business: How businesses are owned. Issues related to ownership are particularly interesting in today's world, where large global businesses coexist with small businesses. In addition, because the majority of businesses are small, we look at specific issues related to small business.

> CHAPTER 4 Choosing a Form of Business Ownership

> CHAPTER 5 Small Business, Entrepreneurship, and Franchises

4 Choosing a Form of Business Ownership

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Learning Objectives

What you will be able to do once you complete this chapter:

1. Describe the advantages and disadvantages of sole proprietorships.
2. Explain the different types of partners and the importance of partnership agreements.
3. Describe the advantages and disadvantages of partnerships.
4. Summarize how a corporation is formed.
5. Describe the advantages and disadvantages of a corporation.
6. Examine special types of corporations, including S-corporations, limited-liability companies, and not-for-profit corporations.
7. Discuss the purpose of a cooperative, joint venture, and syndicate.
8. Explain how growth from within and growth through mergers can enable a business to expand.

inside business

FYI

How Mint.com Makes Money from Money Management

Before he turned 30, Aaron Patzer made a mint by helping people do a better job of managing their money. Patzer came up with the idea for Mint.com in 2006, when he was trying to organize his personal finances. He found existing software programs and online banking systems cumbersome, time-consuming, and costly. So Patzer quit his job and began designing a free Web site where consumers could track all their accounts and, with a click, see where their money was going.

Patzer planned to make money by analyzing users' financial data and suggesting money-saving solutions from credit card companies, banks, and insurance firms that would pay a referral fee whenever a Mint.com user opened an account. He had started small businesses before and knew that incorporating would be an advantage because it would limit the financial liability for Patzer and his investors.

Six months later, Patzer sought funding from investors and venture capital firms to prepare for the launch. Many expressed doubt that consumers would trust their private data to a tiny, unknown start-up. However, the venture capital firm First Round Capital was intrigued by the way Patzer's site would solve a common consumer problem. After watching a demonstration and studying the business plan, the firm invested $325,000 and raised an additional $400,000 from other investors. One of the firm's partners joined Mint.com's board of directors and another became an expert advisor.

The venture capitalists' connections in the tech world helped Patzer contain a crisis that could have crippled Mint.com in its early months. The site had just won an award and as thousands of new users tried to log on, a software glitch knocked the servers out of commission. First Round Capital's partners called their contacts at the software company and made a personal appeal for assistance. Hours later, Mint.com was back in business.

By 2010, Mint.com had raised more than $30 million in investment capital, had more than a million customers, and was adding more than 3,000 new users every day. Patzer then faced the most important decision of his business career. Competitor Intuit, which makes Quicken and Quickbooks software, wanted to buy Mint.com. Should he sell?[1]

Did You Know?

Founder Aaron Patzer raised more than $30 million in venture capital to grow his corporation, Mint.com.

Aaron Patzer started Mint.com with one basic goal: Help people manage their personal finances. To meet this need, Patzer developed a software program that now helps more than a million users track $175 billion in transactions and $47 billion in assets. More importantly, Mint.com has identified more than $300 million in potential savings for the corporation's users.[2] Pretty impressive achievements for a firm that began in 2006. Patzer chose to incorporate his business because this type of business ownership would limit the financial liability for both Patzer and his investors. While some would-be business owners think that if they incorporate, their business will automatically be successful, the fact is that there's more to increasing sales and earning profits than the type of ownership you choose. In today's competitive business world, any corporation, sole proprietorship, or partnership must produce products or services that customers want. And that's what Mint.com does best. The typical Mint.com user finds $1,000 in savings the first time they visit the firm's Web site at http://www.mint.com.[3]

Many people dream of opening a business, and one of the first decisions they must make is what form of ownership to choose. We begin this chapter by describing the three common forms of business ownership: sole proprietorships, partnerships, and corporations. We discuss how these types of businesses are formed and note the advantages and disadvantages of each. Next, we consider several types of business ownership usually chosen for special purposes, including S-corporations, limited-liability companies, not-for-profit corporations, cooperatives, joint ventures, and syndicates. We conclude the chapter with a discussion of how businesses can grow through internal expansion or through mergers with other companies.

1

Describe the advantages and disadvantages of sole proprietorships.

Sole Proprietorships

A **sole proprietorship** is a business that is owned (and usually operated) by one person. Although a few sole proprietorships are large and have many employees, most are small. Sole proprietorship is the simplest form of business ownership and the easiest to start. In most instances, the owner (the *sole* proprietor) simply decides that he or she is in business and begins operations. Some of today's largest corporations, including Ford Motor Company, H.J. Heinz Company, and Procter & Gamble Company, started out as tiny—and in many cases, struggling—sole proprietorships.

As you can see in Figure 4.1, there are approximately 22 million nonfarm sole proprietorships in the United States. They account for 71 percent of the country's business firms. Although the most popular form of ownership when compared with partnerships and corporations, they rank last in total sales revenues. As shown in Figure 4.2, sole proprietorships account for just over $1 trillion, or about 4 percent of total annual sales.

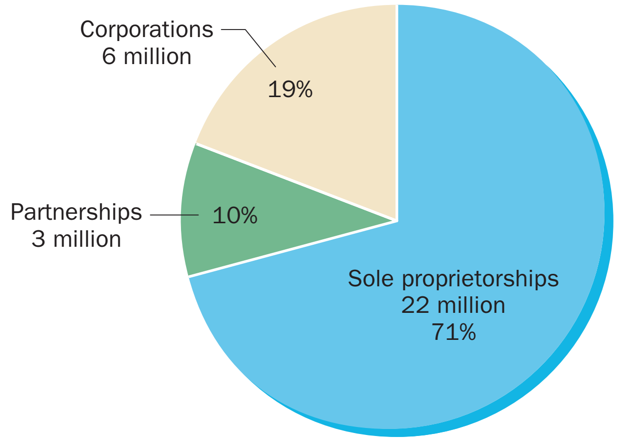
Sole proprietorships are most common in retailing, service, and agriculture. Thus, the clothing boutique, corner grocery, television-repair shop down the street, and small, independent farmers are likely to be sole proprietorships.

Advantages of Sole Proprietorships

Most of the advantages of sole proprietorships arise from the two main characteristics of this form of ownership: simplicity and individual control.

Figure 4.1 Relative Percentages of Nonfarm Sole Proprietorships, Partnerships, and Corporations in the United States

Sole proprietorships, the most common form of business ownership, are most common in retailing, the service industries, and agriculture.



Source: U.S. Bureau of the Census, *Statistical Abstract of the United States* (Washington, DC: Bureau of the Census, 2010), table 729 (http://www.census.gov).

sole proprietorship a business that is owned (and usually operated) by one person

Ease of Start-Up and Closure Sole proprietorship is the simplest and cheapest way to start a business. Often, start-up requires no contracts, agreements, or other legal documents. Thus, a sole proprietorship can be, and most often is, established without the services of an attorney. The legal requirements often are limited to registering the name of the business and obtaining any necessary licenses or permits.

If the enterprise does not succeed, the firm can be closed as easily as it was opened. Creditors must be paid, of course, but generally, the owner does not have to go through any legal procedure before hanging up an "Out of Business" sign.

Pride of Ownership A successful sole proprietor is often very proud of her or his accomplishments—and rightfully so. In almost every case, the owner deserves a great deal of credit for assuming the risks and solving the day-to-day problems associated with operating sole proprietorships. Unfortunately, the reverse is also true. When the business fails, it is often the sole proprietor who is to blame.

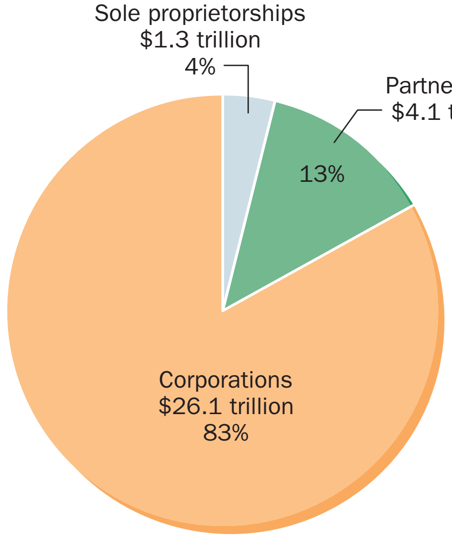
Retention of All Profits Because all profits become the personal earnings of the owner, the owner has a strong incentive to succeed. This direct financial reward attracts many entrepreneurs to the sole proprietorship form of business and, if the business succeeds, is a source of great satisfaction.

No Special Taxes Profits earned by a sole proprietorship are taxed as the personal income of the owner. As a result, sole proprietors must report certain financial information on their personal income tax returns and make estimated quarterly tax payments to the federal government. Thus, a sole proprietorship does not pay the special state and federal income taxes that corporations pay.

Flexibility of Being Your Own Boss A sole proprietor is completely free to make decisions about the firm's operations. Without asking or waiting for anyone's approval, a sole proprietor can switch from retailing to wholesaling, move a shop's location, open a new store, or close an old one. Suppose that the sole proprietor of an appliance

Figure 4.2 Total Sales Receipts of American Businesses

Although corporations account for only about 19 percent of U.S. businesses, they bring in 83 percent of sales receipts.



Source: U.S. Bureau of the Census, *Statistical Abstract of the United States* (Washington, DC: Bureau of the Census, 2010), table 729 (http://www.census gov).

store finds that many customers now prefer to shop on Sunday afternoons. He or she can make an immediate change in business hours to take advantage of this information (provided that state laws allow such stores to open on Sunday). The manager of a store in a large corporate chain such as Best Buy Company may have to seek the approval of numerous managers and company officials before making such a change.

Disadvantages of Sole Proprietorships

The disadvantages of a sole proprietorship stem from the fact that these businesses are owned by one person. Some capable sole proprietors experience no problems. Individuals who start out with few management skills and little money are most at risk for failure.

Unlimited Liability **Unlimited liability** is a legal concept that holds a business owner personally responsible for all the debts of the business. There is legally no difference between the debts of the business and the debts of the proprietor. If the business fails, or if the business is involved in a lawsuit and loses, the owner's personal property—including savings and other assets—can be seized (and sold if necessary) to pay creditors.

Unlimited liability is perhaps the major factor that tends to discourage would-be entrepreneurs with substantial personal wealth from using the sole proprietor form of business organization.

Lack of Continuity Legally, the sole proprietor *is* the business. If the owner retires, dies, or is declared legally incompetent, the business essentially ceases to exist. In many cases, however—especially when the business is a profitable enterprise—the owner's heirs take it over and either sell it or continue to operate it. The business also can suffer if the sole proprietor becomes ill and cannot work for an extended period of time. If the owner, for example, has a heart attack, there is often no one who can step in and manage the business. An illness can be devastating if the sole proprietor's personal skills are what determine if the business is a success or a failure.

Lack of Money Banks, suppliers, and other lenders usually are unwilling to lend large sums of money to sole proprietorships. Only one person—the sole proprietor—can be held responsible for repaying such loans, and the assets of most sole proprietors usually are limited. Moreover, these assets may have been used already as the basis for personal borrowing (a home mortgage or car loan) or for short-term credit from suppliers. Lenders also worry about the lack of continuity of sole proprietorships: Who will repay a loan if the sole proprietor dies? Finally, many lenders are concerned about the large number of sole proprietorships that fail—a topic discussed in Chapter 5.

The limited ability to borrow money can prevent a sole proprietorship from growing. It is the main reason that many business owners, when in need of relatively large amounts of capital, change from a sole proprietorship to a partnership or corporate form of ownership.

Limited Management Skills The sole proprietor is often the sole manager—in addition to being the only salesperson, buyer, accountant, and, on occasion, janitor. Even the most experienced business owner is unlikely to have expertise in all these areas. Unless he or she obtains the necessary expertise by hiring employees, assistants, or consultants, the business can suffer in the areas in which the owner is less knowledgeable. For the many sole proprietors who cannot hire the help they need, there just are not enough hours in the day to do everything that needs to be done.

unlimited liability a legal concept that holds a business owner personally responsible for all the debts of the business

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A builder with a dream. As a homebuilder, Shelley Reynolds, owner and president of Reynolds Signature Homes, has faced new challenges since the downturn in home sales that began three years ago. In most areas of the United States, there are fewer homeowners that can qualify for home mortgages, which makes it hard for business owners like Reynolds to construct upscale homes and sell them for a profit.

Entrepreneurial
SUCCESS

Student Business Incubators

Whether you're starting a new venture or expanding an existing company, you may be able to get expert help, office space, and even some funding without leaving your campus, if your school has a student business incubator. A growing number of colleges and universities are setting up incubators to help student entrepreneurs choose an appropriate form of business ownership and proceed to develop, test, implement, and refine their business ideas in a supportive environment.

The incubator at the University of Northern Iowa, for instance, invites student entrepreneurs to apply for a semester of on-campus assistance, including legal and accounting services, management training, and access to seed funds. Carlos Arguello was the first student entrepreneur to "graduate" from this incubator, working with his mother to successfully launch the Spanish-language newspaper *La Prensa* in northern Iowa.

At the University of Wisconsin-Madison, student entrepreneurs compete for six spaces in the on-campus incubator by submitting a written application and making a presentation to the Student Business Incubator Board. At the University of Michigan, the TechArb incubator houses up to 12 student-owned high-tech businesses at a time. One recent tenant was Mobil33t, which designed the iPhone app DoGood to encourage people to do a good deed every day. Can an incubator set you on the path toward entrepreneurial success?

Sources: Nathan Bomey, "University of Michigan Strikes Deal to Establish Permanent Student Business Incubator," *AnnArbor.com,* November 5, 2009, http://www.annarbor.com/business-review/university-of-michigan-strikes-deal-to-establish-permanent-student-business-incubator/; University of Wisconsin-Madison Student Business Incubator, http://www.asm.wisc.edu/sbi.html; University of Northern Iowa Student Business Incubator, http://www.bcs.uni.edu/jpec/sbi.htm.

Difficulty in Hiring Employees The sole proprietor may find it hard to attract and keep competent help. Potential employees may feel that there is no room for advancement in a firm whose owner assumes all managerial responsibilities. And when those who *are* hired are ready to take on added responsibility, they may find that the only way to do so is to quit the sole proprietorship and go to work for a larger firm or start up their own businesses. The lure of higher salaries and increased benefits (especially health insurance) also may cause existing employees to change jobs.

Beyond the Sole Proprietorship

Like many others, you may decide that the major disadvantage of a sole proprietorship is the limited amount that one person can do in a workday. One way to reduce the effect of this disadvantage (and retain many of the advantages) is to have more than one owner.

2

Explain the different types of partners and the importance of partnership agreements.

Partnerships

A person who would not think of starting and running a business alone may enthusiastically seize the opportunity to enter into a business partnership. The U.S. Uniform Partnership Act defines a **partnership** as a voluntary association of two or more persons to act as co-owners of a business for profit. For example, in 1990, two young African-American entrepreneurs named Janet Smith and Gary Smith started Ivy Planning Group—a company that provides strategic planning and performance measurement for clients. Today, more than 20 years later, the company has evolved into a multimillion-dollar company that has hired a diverse staff of employees and provides cultural diversity training for *Fortune* 1,000 firms, large not-for-profit organizations, and government agencies. In recognition of its efforts, Ivy Planning Group has been honored by DiversityBusiness.com as one of the top 50 minority-owned companies and by *Black Enterprise* and *Working Mother* magazines. And both Janet Smith and Gary Smith—Ivy Planning Group's founders—have been named "1 of 50 Most Influential Minorities in Business" by Minority Business and Professionals Network.[4]

As shown in Figures 4.1 and 4.2, there are approximately 3 million partnerships in the United States, and this type of ownership accounts for about $4.1 trillion in sales receipts each year. Note, however, that this form of ownership is much less common than the sole proprietorship or the corporation. In fact, as Figure 4.1 shows, partnerships

partnership a voluntary association of two or more persons to act as co-owners of a business for profit represent only about 10 percent of all American businesses. Although there is no legal maximum on the number of partners a partnership may have, most have only two. Large accounting, law, and advertising partnerships, however, are likely to have multiple partners. Regardless of the number of people involved, a partnership often represents a pooling of special managerial skills and talents; at other times, it is the result of a sole proprietor's taking on a partner for the purpose of obtaining more capital.

Types of Partners

All partners are not necessarily equal. Some may be active in running the business, whereas others may have a limited role.

General Partners A **general partner** is a person who assumes full or shared responsibility for operating a business. General partners are active in day-to-day business operations, and each partner can enter into contracts on behalf of the other partners. He or she also assumes unlimited liability for all debts, including debts incurred by any other general partner without his or her knowledge or consent. A *general partnership* is a business co-owned by two or more general partners who are liable for everything the business does. To avoid future liability, a general partner who withdraws from the partnership must give notice to creditors, customers, and suppliers.

general partner a person who assumes full or shared responsibility for operating a business

limited partner a person who contributes capital to a business but has no management responsibility or liability for losses beyond the amount he or she invested in the partnership

master limited partnership (MLP) a business partnership that is owned and managed like a corporation but often taxed like a partnership

Limited Partners A **limited partner** is a person who invests money in a business but who has no management responsibility or liability for losses beyond his or her investment in the partnership. A *limited partnership* is a business co-owned by one or more general partners who manage the business and limited partners who invest money in it. Limited partnerships may be formed to finance real estate, oil and gas, motion picture, and other business ventures. Typically, the general partner or partners collect management fees and receive a percentage of profits. Limited partners receive a portion of profits and tax benefits.

Because of potential liability problems, special rules apply to limited partnerships. These rules are intended to protect customers and creditors who deal with limited partnerships. For example, prospective partners in a limited partnership must file a formal declaration, usually with the secretary of state, that describes the essential details of the partnership and the liability status of each partner involved in the business. At least one general partner must be responsible for the debts of the limited partnership. Also, some states prohibit the use of the limited partner's name in the partnership's name.

A special type of limited partnership is referred to as a *master limited partnership*. A **master limited partnership (MLP)** (sometimes referred to as a *publicly traded partnership,* or PTP) is a business partnership that is owned and managed like a corporation but often taxed like a partnership. This special ownership arrangement has a major advantage. Units of ownership in MLPs can be sold to investors to raise capital and often are traded on organized security exchanges. Because MLP units can be traded on an exchange, investors can sell their units of ownership at any time, hopefully for a profit. For more information on MLPs, visit the National Association of Publicly Traded Partnerships Web site at http://www.naptp.org.

Originally, there were tax advantages to forming an MLP because profits from this special type of partnership were reported as personal income. MLPs thus avoided the double taxation paid on corporate income. Today, the Internal Revenue Service has limited many of the tax advantages of MLPs. While there are exceptions, most MLPs typically are in natural resources, energy, or real estate-related businesses.[5]

Often two heads are better than one! Kevin and Mellisa Berger recently purchased and remodeled the Zesto Drive In in Jefferson City, Missouri. Today many married couples—like the Bergers—form a special type of partnership with each partner using his or her own unique skills and talents to build a successful business.

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The Partnership Agreement

Articles of partnership refers to an agreement listing and explaining the terms of the partnership. Although both oral and written partnership agreements are legal and can be enforced in the courts, a written agreement has an obvious advantage. It is not subject to lapses of memory.

Figure 4.3 shows a typical partnership agreement. The partnership agreement should state who will make the final decisions, what each partner's duties will be, and the investment each partner will make. The partnership agreement also should state how much profit or loss each partner receives or is responsible for. Finally, the partnership agreement should state what happens if a partner wants to dissolve the partnership or dies. Although the people involved in a partnership can draft their own agreement, most experts recommend consulting an attorney.

When entering into a partnership agreement, partners would be wise to let a neutral third party—a consultant, an accountant, a lawyer, or a mutual friend—assist with any disputes that might arise.

Figure 4.3 Articles of Partnership

The articles of partnership is a written or oral agreement that lists and explains the terms of a partnership.

PARTNERSHIP AGREEMENT

Names of partners	This agreement, made June 20, 2010, between Penelope Wolfburg of 783A South Street, Hazelton, Idaho, and Ingrid Swenson of RR 5, Box 96, Hazelton, Idaho.
Nature, name, and address of business	1. The above named persons have this day formed a partnership that shall operate under the name of W-S Jewelers, located at 85 Broad Street, Hazelton, Idaho 83335, and shall engage in jewelry sales and repairs.
Duration of partnership	2. The duration of this agreement will be for a term of fifteen (15) years, beginning June 20, 2010, or for a shorter period if agreed upon in writing by both partners.
Contribution of capital	3. The initial investment by each partner will be as follows: Penelope Wolfburg, assets and liabilities of Wolfburg's Jewelry Store, valued at a capital investment of $40,000; Ingrid Swenson, cash of $20,000. These investments are partnership property.
Duties of each partner	4. Each partner will give her time, skill, and attention to the operation of this partnership and will engage in no other business enterprise unless permission is granted in writing by the other partner.
Salaries, withdrawals, and distribution of profits	5. The salary for each partner will be as follows: Penelope Wolfburg, $40,000 per year; Ingrid Swenson, $30,000 per year. Neither partner may withdraw cash or other assets from the business without express permission in writing from the other partner. All profits and losses of the business will be shared as follows: Penelope Wolfburg, 60 percent; Ingrid Swenson, 40 percent.
Termination	6. Upon the dissolution of the partnership due to termination of this agreement, or to written permission by each of the partners, or to the death or incapacitation of one or both partners, a new contract may be entered into by the partners or the sole continuing partner has the option to purchase the other partner's interest in the business at a price that shall not exceed the balance in the terminating partner's capital account. The payment shall be made in cash in equal quarterly installments from the date of termination.
	7. At the conclusion of this contract, unless it is agreed by both partners to continue the operation of the business under a new contract, the assets of the partnership, after the liabilities are paid, will be divided in proportion to the balance in each partner's capital account on that date.
Signatures	*Penelope Wolfburg* — Penelope Wolfburg; *Ingrid Swenson* — Ingrid Swenson
Date	*June 20, 2010* — Date; *June 20, 2010* — Date

Source: Adapted from Goldman and Sigismond, *Business Law,* 8th ed. (Mason, OH: South-Western Cengage Learning, 2011). Copyright © 2011 by Cengage Learning Company. Reprinted with permission.

3

Describe the advantages and disadvantages of partnerships.

Advantages of Partnerships

Partnerships have many advantages. The most important are described below.

Ease of Start-Up Partnerships are relatively easy to form. As with a sole proprietorship, the legal requirements often are limited to registering the name of the business and obtaining any necessary licenses or permits. It may not even be necessary to prepare written articles of partnership, although doing so is generally a good idea.

Availability of Capital and Credit Because partners can pool their funds, a partnership usually has more capital available than a sole proprietorship does. This additional capital, coupled with the general partners' unlimited liability, can form the basis for a better credit rating. Banks and suppliers may be more willing to extend credit or approve larger loans to such a partnership than to a sole proprietor. This does not mean that partnerships can borrow all the money they need. Many partnerships have found it hard to get long-term financing simply because lenders worry about the possibility of management disagreements and lack of continuity.

Personal Interest General partners are very concerned with the operation of the firm—perhaps even more so than sole proprietors. After all, they are responsible for the actions of all other general partners, as well as for their own. The pride of ownership from solving the day-to-day problems of operating a business—with the help of another person(s)—is a strong motivating force and often makes all the people involved in the partnership work harder to become more successful.

Combined Business Skills and Knowledge Partners often have complementary skills. The weakness of one partner—in manufacturing, for example—may be offset by another partner's strength in that area. Moreover, the ability to discuss important decisions with another concerned individual often relieves some pressure and leads to more effective decision making.

Retention of Profits As in a sole proprietorship, all profits belong to the owners of the partnership. The partners share directly in the financial rewards and therefore are highly motivated to do their best to make the firm succeed. As noted, the partnership agreement should state how much profit or loss each partner receives or is responsible for.

No Special Taxes Although a partnership pays no income tax, the Internal Revenue Service requires partnerships to file an annual information return that states the names and addresses of all partners involved in the business. The return also must provide information about income and expenses and distributions made to each partner. Then each partner is required to report his or her share of profit (or loss) from the partnership business on his or her individual tax return and is taxed on his or her share of the profit—in the same way a sole proprietor is taxed.

Disadvantages of Partnerships

Although partnerships have many advantages when compared with sole proprietorships and corporations, they also have some disadvantages, which anyone thinking of forming a partnership should consider.

Two entrepreneurs with one goal. The goal for Matt Flannery (right) and Premal Shah (left) when they co-founded Kiva.org was to create an organization that would connect people, through lending, for the sake of alleviating poverty. Have the two partners been successful? You bet—at the beginning of 2010, Kiva.org had facilitated over $100 million in loans. For more information about Kiva.org or to become a lender and get involved, go to http://www.kiva.org.

© Gary Reyes/San Jose Mercury News/MCT/Newscom

Unlimited Liability As we have noted, each *general* partner has unlimited liability for all debts of the business. Each partner is legally and personally responsible for the debts, taxes, and actions of any other partner conducting partnership business, even if that partner did not incur those debts or do anything wrong. General partners thus run the risk of having to use their personal assets to pay creditors. *Limited* partners, however, risk only their original investment.

Today, many states allow partners to form a *limited-liability partnership* (LLP), in which a partner may have limited-liability protection from legal action resulting from the malpractice or negligence of the other partners. Most states that allow LLPs restrict this type of ownership to certain types of professionals such as accountants, architects, attorneys, and similar professionals. (Note the difference between a limited partnership and a limited-liability partnership. A limited partnership must have at least one general partner that has unlimited liability. On the other hand, all partners in a limited-liability partnership may have limited liability *for the malpractice of the other partners*.)

SPOTLIGHT

Where the jobs are!

Source: The U.S. Census Bureau, *Statistical Abstract of the United States*, 2010, table 742.

Management Disagreements What happens to a partnership if one of the partners brings a spouse or a relative into the business? What happens if a partner wants to withdraw more money from the business? Notice that each of the preceding situations—and for that matter, most of the other problems that can develop in a partnership—involves one partner doing something that disturbs the other partner(s). This human factor is especially important because business partners—with egos, ambitions, and money on the line—are especially susceptible to friction. When partners begin to disagree about decisions, policies, or ethics, distrust may build and get worse as time passes—often to the point where it is impossible to operate the business successfully.

Lack of Continuity Partnerships are terminated if any one of the general partners dies, withdraws, or is declared legally incompetent. However, the remaining partners can purchase that partner's ownership share. For example, the partnership agreement may permit surviving partners to continue the business after buying a deceased partner's interest from his or her estate. However, if the partnership loses an owner whose specific management or technical skills cannot be replaced, it is not likely to survive.

Frozen Investment It is easy to invest money in a partnership, but it is sometimes quite difficult to get it out. This is the case, for example, when remaining partners are unwilling to buy the share of the business that belongs to a partner who retires or wants to relocate to another city. To avoid such difficulties, the partnership agreement should include some procedure for buying out a partner.

In some cases, a partner must find someone outside the firm to buy his or her share. How easy or difficult it is to find an outsider depends on how successful the business is and how willing existing partners are to accept a new partner.

Beyond the Partnership

The main advantages of a partnership over a sole proprietorship are the added capital and management expertise of the partners. However, some of the basic disadvantages of the sole proprietorship also plague the general partnership. One disadvantage in particular—unlimited liability—can cause problems for a partner with substantial personal wealth. A third form of business ownership, the corporation, overcomes this disadvantage.

4

Summarize how a corporation is formed.

Corporations

Back in 1837, William Procter and James Gamble—two sole proprietors—formed a partnership called Procter & Gamble (P&G) and set out to compete with 14 other soap and candle makers in Cincinnati, Ohio. Then, in 1890, Procter & Gamble incorporated to raise additional capital for expansion that eventually allowed the company to become a global giant. Today, 4 billion times a day, Procter & Gamble brands touch the lives of people in 180 countries around the globe.[6] Like many large corporations, P&G's market capitalization is greater than the gross domestic product of many countries. Although this corporation is a corporate giant, the firm's executives and employees believe it also has a responsibility to be an ethical corporate citizen. For example, P&G's purpose statement (or mission) is

> *We will provide branded products and services of superior quality and value that improve the lives of the world's consumers, now and for generations to come. As a result, consumers will reward us with leadership sales, profit and value creation, allowing our people, our shareholders and the communities in which we live and work to prosper.*[7]

corporation an artificial person created by law with most of the legal rights of a real person, including the rights to start and operate a business, to buy or sell property, to borrow money, to sue or be sued, and to enter into binding contracts

stock the shares of ownership of a corporation

stockholder a person who owns a corporation's stock

In today's competitive environment, it's common to hear of large companies that are profitable. It is less common to hear of profitable companies that are held in high regard because they are good corporate citizens.

While not all sole proprietorships and partnerships become corporations, there are reasons why business owners choose the corporate form of ownership. Let's begin with a definition of a corporation. Perhaps the best definition of a corporation was given by Chief Justice John Marshall in a famous Supreme Court decision in 1819. A corporation, he said, "is an artificial person, invisible, intangible, and existing only in contemplation of the law." In other words, a **corporation** (sometimes referred to as a *regular* or *C-corporation*) is an artificial person created by law, with most of the legal rights of a real person. These include:

- The right to start and operate a business
- The right to buy or sell property
- The right to borrow money
- The right to sue or be sued
- The right to enter into binding contracts

Unlike a real person, however, a corporation exists only on paper. There are approximately 6 million corporations in the United States. They comprise about 19 percent of all businesses, but they account for 83 percent of sales revenues (see Figures 4.1 and 4.2). Table 4.1 lists the seven largest U.S. industrial corporations, ranked according to sales.

Would you believe a major corporation was started in this building? The building in this photo was once used by Bill Hewlett and Dave Packard as a research lab, development workshop, and manufacturing facility. Their efforts paid off, and today Hewlett-Packard Corporation is one of the world's leading technology companies. By the way, this building is now a historic landmark and is considered to be the birthplace of Silicon Valley.

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Corporate Ownership

The shares of ownership of a corporation are called **stock**. The people who own a corporation's stock—and thus own part of the corporation—are called **stockholders**. Once a corporation has been formed, it may sell its stock

Table 4.1	The Seven Largest U.S. Industrial Corporations, Ranked by Sales Revenues		
Rank	Company	Revenues ($ millions)	Profits ($ millions)
1	ExxonMobil	442,851.0	45,220.0
2	Walmart Stores	405,607.0	13,400.0
3	Chevron	263,159.0	23,931.0
4	ConocoPhillips	230,764.0	−16,998.0
5	General Electric	183,207.0	17,410.0
6	General Motors	148,979.0	−30,860.0
7	Ford Motor	146,277.0	−14,672.0

Source: *Fortune* Web site at http://www.fortune.com (accessed March 16, 2010). September 12, 2008. Copyright © 2008. Reprinted by permission.

to individuals or other companies that want to invest in the corporation. It also may issue stock as a reward to key employees in return for certain services or as a return to investors in place of cash payments.

A **closed corporation** is a corporation whose stock is owned by relatively few people and is not sold to the general public. As an example, DeWitt and Lila Wallace owned virtually all the stock of Reader's Digest Association, making it one of the largest corporations of this kind. A person who wishes to sell the stock of a closed corporation generally arranges to sell it privately to another stockholder or a close acquaintance.

Although founded in 1921 as a closed corporation, the Reader's Digest Association became an open corporation when it sold stock to investors for the first time in 1990. (*Note:* In 2007, Reader's Digest Association became a closed corporation once again after the firm was purchased by a group of investors.)

An **open corporation** is one whose stock can be bought and sold by any individual. Examples of open corporations include General Electric, Microsoft, and Johnson & Johnson.

Forming a Corporation

Although you may think that incorporating a business guarantees success, it does not. There is no special magic about placing the word *Incorporated* or the abbreviation *Inc.* after the name of a business. Unfortunately, like sole proprietorships or partnerships, incorporated businesses can go broke. The decision to incorporate a business therefore should be made only after carefully considering whether the corporate form of ownership suits your needs better than the sole proprietorship or partnership forms.

If you decide that the corporate form is the best form of organization for you, most experts recommend that you begin the incorporation process by consulting a lawyer to be sure that all legal requirements are met. While it may be possible to incorporate a business without legal help, it is well to keep in mind the old saying, "A man who acts as his own attorney has a fool for a client." Table 4.2 lists some aspects of starting and running a business that may require legal help.

Where to Incorporate A business is allowed to incorporate in any state that it chooses. Most small- and medium-sized businesses are incorporated in the state where they do the most business. The founders of larger corporations or of those that will do business nationwide often compare the benefits that various states provide to corporations. The decision on where to incorporate usually is based on two factors: (1) the cost of incorporating in one state compared with the cost in another state and (2) the advantages and disadvantages of each state's corporate laws and tax structure. Some states are more hospitable than others, and some offer fewer restrictions, lower taxes, and other benefits to attract new firms. Delaware and Nevada are often chosen by corporations that do business in more than one state because of their corporation-friendly laws.[8]

closed corporation a corporation whose stock is owned by relatively few people and is not sold to the general public

open corporation a corporation whose stock can be bought and sold by any individual

Table 4.2	Ten Aspects of Business that May Require Legal Help
1. Choosing either the sole proprietorship, partnership, corporate, or some special form of ownership	6. Filing for licenses or permits at the local, state, and federal levels
2. Constructing a partnership agreement	7. Purchasing an existing business or real estate
3. Incorporating a business	8. Creating valid contracts
4. Registering a corporation's stock	9. Hiring employees and independent contractors
5. Obtaining a trademark, patent, or copyright	10. Extending credit and collecting debts

An incorporated business is called a **domestic corporation** in the state in which it is incorporated. In all other states where it does business, it is called a **foreign corporation**. Sears Holdings Corporation, the parent company of Sears and Kmart, is incorporated in Delaware, where it is a domestic corporation. In the remaining 49 states, Sears is a foreign corporation. Sears must register in all states where it does business and also pay taxes and annual fees to each state. A corporation chartered by a foreign government and conducting business in the United States is an **alien corporation**. Volkswagen AG, Sony Corporation, and the Royal Dutch/Shell Group are examples of alien corporations.

The Corporate Charter Once a home state has been chosen, the incorporator(s) submits *articles of incorporation* to the secretary of state. When the articles of incorporation are approved, they become a contract between a corporation and the state in which the state recognizes the formation of the artificial person that is the corporation. Usually, the articles of incorporation include the following information:

- The firm's name and address
- The incorporators' names and addresses
- The purpose of the corporation
- The maximum amount of stock and types of stock to be issued
- The rights and privileges of stockholders
- The length of time the corporation is to exist

To help you to decide if the corporate form of organization is the right choice, you may want to review the material available on the Yahoo! Small Business Web site (http://smallbusiness.yahoo.com). Once at the site, click on Resources. In addition, before making a decision to organize your business as a corporation, you may want to consider two additional areas: stockholders' rights and the importance of the organizational meeting.

Stockholders' Rights There are two basic types of stock. Owners of **common stock** may vote on corporate matters. Generally, an owner of common stock has one vote for each share owned. However, any claims of common-stock owners on profits and assets of the corporation are subordinate to the claims of others. The owners of **preferred stock** usually have no voting rights, but their claims on dividends are paid before those of common-stock owners. Although large corporations may issue both common and preferred stock, generally small corporations issue only common stock.

Perhaps the most important right of owners of both common and preferred stock is to share in the profit earned by the corporation through the payment of dividends. A **dividend** is a distribution of earnings to the stockholders of a corporation. Other rights include receiving information about the corporation, voting on changes to the corporate charter, and attending the corporation's annual stockholders' meeting, where they may exercise their right to vote.

Because common stockholders usually live all over the nation, very few actually may attend a corporation's annual meeting. Instead, they vote by proxy. A **proxy** is a legal form listing issues to be decided at a stockholders' meeting and enabling

domestic corporation a corporation in the state in which it is incorporated

foreign corporation a corporation in any state in which it does business except the one in which it is incorporated

alien corporation a corporation chartered by a foreign government and conducting business in the United States

common stock stock owned by individuals or firms who may vote on corporate matters but whose claims on profits and assets are subordinate to the claims of others

preferred stock stock owned by individuals or firms who usually do not have voting rights but whose claims on dividends are paid before those of common-stock owners

dividend a distribution of earnings to the stockholders of a corporation

proxy a legal form listing issues to be decided at a stockholders' meeting and enabling stockholders to transfer their voting rights to some other individual or individuals stockholders to transfer their voting rights to some other individual or individuals. The stockholder can register a vote and transfer voting rights simply by signing and returning the form. Today, most corporations also allow stockholders to exercise their right to vote by proxy by accessing the Internet or using a toll-free phone number.

Organizational Meeting

As the last step in forming a corporation, the incorporators and original stockholders meet to adopt corporate by-laws and elect their first board of directors. (Later, directors will be elected or reelected at the corporation's annual meetings.) The board members are directly responsible to the stockholders for the way they operate the firm.

Three corporate executives with a mission. At a recent press conference, PepsiCo announced that it will acquire its two anchor bottlers in order to provide enhanced customer service and drive the company's efforts to increase innovation. In this photo, Indra Nooyi, Chairperson of the Board and Chief Executive Officer of PepsiCo (center), is pictured with Robert Pohlad, Chairman of PepsiAmericas (left), and Eric Foss, Chairperson of the Pepsi Bottling Group.

© AP Images/PRNewsFoto/PepsiCo

Corporate Structure

The organizational structure of most corporations is more complicated than that of a sole proprietorship or partnership. This is especially true as the corporation begins to grow and expand. In a corporation, both the board of directors and the corporate officers are involved in management.

Board of Directors

As an artificial person, a corporation can act only through its directors, who represent the corporation's stockholders. The **board of directors** is the top governing body of a corporation and is elected by the stockholders. Board members can be chosen from within the corporation or from outside it. *Note:* For a small corporation, only one director is required in many states although you can choose to have more.

Directors who are elected from within the corporation are usually its top managers—the president and executive vice presidents, for example. Those elected from outside the corporation generally are experienced managers or entrepreneurs with proven leadership ability and/or specific talents the organization seems to need. In smaller corporations, majority stockholders usually serve as board members.

The major responsibilities of the board of directors are to set company goals and develop general plans (or strategies) for meeting those goals. The board also is responsible for the firm's overall operation.

Corporate Officers

Corporate officers are appointed by the board of directors. Although a small corporation may not have all of the following officers, the chairman of the board, president, executive vice presidents, corporate secretary, and treasurer are all corporate officers. They help the board to make plans, carry out strategies established by the board, hire employees, and manage day-to-day business activities. Periodically (usually each month), they report to the board of directors. And at the annual meeting, the directors report to the stockholders. In theory, then, the stockholders are able to control the activities of the entire corporation through its directors because they are the group that elects the board of directors (see Figure 4.4).

board of directors the top governing body of a corporation, the members of which are elected by the stockholders

corporate officers the chairman of the board, president, executive vice presidents, corporate secretary, treasurer, and any other top executive appointed by the board of directors

Figure 4.4 Hierarchy of Corporate Structure

Stockholders exercise a great deal of influence through their right to elect the board of directors.

5

Describe the advantages and disadvantages of a corporation.

Advantages of Corporations

Back in October 2000, Manny Ruiz decided that it was time to start his own company. With the help of a team of media specialists, he founded Hispanic PR Wire. In a business where hype is the name of the game, Hispanic PR Wire is the real thing and has established itself as the nation's premier news distribution service reaching U.S. Hispanic media and opinion leaders. Today, the business continues to build on its early success.[9] Mr. Ruiz chose to incorporate this business because it provided a number of advantages that other forms of business ownership did not offer. Typical advantages include limited liability, ease of raising capital, ease of transfer of ownership, perpetual life, and specialized management.

Limited Liability One of the most attractive features of corporate ownership is **limited liability**. With few exceptions, each owner's financial liability is limited to the amount of money he or she has paid for the corporation's stock. This feature arises from the fact that the corporation is itself a legal person, separate from its owners. If a corporation fails or is involved in a lawsuit and loses, creditors have a claim only on the corporation's assets, not on the owners' (stockholders') personal assets. Because it overcomes the problem of unlimited liability connected with sole proprietorships and general partnerships, limited liability is one of the chief reasons why entrepreneurs often choose the corporate form of organization.

limited liability a feature of corporate ownership that limits each owner's financial liability to the amount of money that he or she has paid for the corporation's stock

Ease of Raising Capital The corporation is by far the most effective form of business ownership for raising capital. Like sole proprietorships and partnerships, corporations can borrow from lending institutions. However, they also can raise additional sums of money by selling stock. Individuals are more willing to invest in corporations than in other forms of business because of limited liability, and they can sell their stock easily—hopefully for a profit.

Where did all these products come from? One company—the 3M Company—is known for its financial commitment to funding research to develop innovative products. One of the advantages of the corporate form of ownership is that a company like 3M can sell stock to raise the money needed to begin operations, to fund expansion, *and* to pay for new product research and development.

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Ease of Transfer of Ownership Accessing a brokerage firm Web site or a telephone call to a stockbroker is all that is required to put most stock up for sale. Willing buyers are available for most stocks at the market price. Ownership is transferred when the sale is made, and practically no restrictions apply to the sale and purchase of stock issued by an open corporation.

Perpetual Life Since it is essentially a legal "person," a corporation exists independently of its owners and survives them. The withdrawal, death, or incompetence of a key executive or owner does not cause the corporation to be terminated. Sears, Roebuck and Co. incorporated in 1893 and is one of the nation's largest retailing corporations, even though its original co-founders, Richard Sears and Alvah Roebuck, have been dead for decades.

Specialized Management Typically, corporations are able to recruit more skilled, knowledgeable, and talented managers than proprietorships and partnerships. This is so because they pay bigger salaries, offer excellent fringe benefits, and are large enough to offer considerable opportunity for advancement. Within the corporate structure, administration, human resources, finance, marketing, and operations are placed in the charge of experts in these fields.

Disadvantages of Corporations

Like its advantages, many of a corporation's disadvantages stem from its legal definition as an artificial person or legal entity. The most serious disadvantages are described in the following text. (See Table 4.3 for a

Table 4.3	Some Advantages and Disadvantages of a Sole Proprietorship, Partnership, and Corporation		
	Sole Proprietorship	General Partnership	Regular C-Corporation
Protecting against liability for debts	Difficult	Difficult	Easy
Raising money	Difficult	Difficult	Easy
Ownership transfer	Difficult	Difficult	Easy
Preserving continuity	Difficult	Difficult	Easy
Government regulations	Few	Few	Many
Formation	Easy	Easy	Difficult
Income taxation	Once	Once	Twice

comparison of some of the advantages and disadvantages of a sole proprietorship, general partnership, and corporation.)

Difficulty and Expense of Formation Forming a corporation can be a relatively complex and costly process. The use of an attorney is usually necessary to complete the legal forms that are submitted to the secretary of state. Application fees, attorney's fees, registration costs associated with selling stock, and other organizational costs can amount to thousands of dollars for even a medium-sized corporation. The costs of incorporating, in terms of both time and money, discourage many owners of smaller businesses from forming corporations.

Government Regulation and Increased Paperwork A corporation must meet various government standards before it can sell its stock to the public. Then it must file many reports on its business operations and finances with local, state, and federal governments. In addition, the corporation must make periodic reports to its stockholders about various aspects of the business. To prepare all the necessary reports, even small corporations often need the help of an attorney, certified public accountant, and other professionals on a regular basis. In addition, a corporation's activities are restricted by law to those spelled out in its charter.

Conflict Within the Corporation Because a large corporation may employ thousands of employees, some conflict is inevitable. For example, the pressure to increase sales revenue, reduce expenses, and increase profits often leads to increased stress and tension for both managers and employees. This is especially true when a corporation operates in a competitive industry, attempts to develop and market new products, or must downsize the workforce to reduce employee salary expense during an economic crisis.

Double Taxation Corporations must pay a tax on their profits. In addition, stockholders must pay a personal income tax on profits received as dividends. Corporate profits thus are taxed twice—once as corporate income and a second time as the personal income of stockholders. *Note:* Both the S-corporation and the limited-liability company discussed in the next section eliminate the disadvantage of double taxation because they are taxed like a partnership. These special types of ownership still provide limited liability for the personal assets of the owners.

Lack of Secrecy Because open corporations are required to submit detailed reports to government agencies and to stockholders, they cannot keep their operations confidential. Competitors can study these corporate reports and then use the information to compete more effectively. In effect, every public corporation has to share some of its secrets with its competitors.

6

Examine special types of corporations, including S-corporations, limited-liability companies, and not-for-profit corporations.

Special Types of Business Ownership

In addition to the sole proprietorship, partnership, and the regular corporate form of organization, some entrepreneurs choose other forms of organization that meet their special needs. Additional organizational options include S-corporations, limited-liability companies, and not-for-profit corporations.

S-Corporations

If a corporation meets certain requirements, its directors may apply to the Internal Revenue Service for status as an S-corporation. An **S-corporation** is a corporation that is taxed as though it were a partnership. In other words, the corporation's income is taxed only as the personal income of its stockholders. Corporate profits or losses "pass through" the business and are reported on the owners' personal income tax returns.

To qualify for the special status of an S-corporation, a firm must meet the following criteria:[10]

S-corporation a corporation that is taxed as though it were a partnership

limited-liability company (LLC) a form of business ownership that combines the benefits of a corporation and a partnership while avoiding some of the restrictions and disadvantages of those forms of ownership

1. No more than 100 stockholders are allowed.
2. Stockholders must be individuals, estates, or certain trusts.
3. There can be only one class of outstanding stock.
4. The firm must be a domestic corporation eligible to file for S-corporation status.
5. There can be no partnerships, corporations, or nonresident-alien stockholders.
6. All stockholders must agree to the decision to form an S-corporation.

Becoming an S-corporation can be an effective way to avoid double taxation while retaining the corporation's legal benefit of limited liability.

American Girl: A limited-liability company. A limited-liability company (LLC) doesn't have to be small. The truth is that even large companies like American Girl often choose the LLC form of business ownership. American Girl, LLC, chose this type of business ownership because it provided limited liability for investors and avoided some of the restrictions and disadvantages of other forms of business ownership.

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Limited-Liability Companies

A new form of ownership called a *limited-liability company* has been approved in all 50 states—although each state's laws may differ. A **limited-liability company (LLC)** is a form of business ownership that combines the benefits of a corporation and a partnership while avoiding some of the restrictions and disadvantages of those forms of ownership. Chief advantages of an LLC are as follows:

1. LLCs with at least two members are taxed like a partnership and thus avoid the double taxation imposed on most corporations. LLCs with just one member are taxed like a sole proprietorship. LLCs can even elect to be taxed as a corporation if there are benefits to offset the corporate double taxation.
2. Like a corporation, it provides limited-liability protection for acts and debts of the LLC. An LLC thus extends the concept of personal-asset protection to small business owners.
3. The LLC type of organization provides more management flexibility when compared with corporations. A corporation, for example, is required to hold annual meetings and record meeting minutes; an LLC is not.

Although many experts believe that the LLC is nothing more than a variation of the S-corporation, there is a difference. An LLC is not restricted to 100 stockholders—a common drawback of the S-corporation. LLCs are also less restricted and have more flexibility than S-corporations in terms of who can become an owner. Although the owners of an LLC may file the required articles of organization in any state, most choose to file in their home state—the state where they do most of their business. For more information about the benefits of forming an LLC, go to http://www.llc.com.

Because of the increased popularity of the LLC form of organization, experts are predicting that LLCs may become one of the most popular forms of business ownership available. For help in understanding the differences between a regular corporation, S-corporation, and limited-liability company, see Table 4.4.

Not-for-Profit Corporations

A **not-for-profit corporation** (sometimes referred to as *non-profit*) is a corporation organized to provide a social, educational, religious, or other service rather than to earn a profit. Various charities, museums, private schools, colleges, and charitable organizations are organized in this way, primarily to ensure limited liability.

While the process used to organize a not-for-profit corporation is similar to the process used to create a regular corporation, each state does have different laws. In fact, many of the requirements are different than the requirements for establishing a regular corporation. Once approved by state authorities, not-for-profit corporations must meet specific Internal Revenue Service guidelines in order to obtain tax-exempt status.

Today, there is a renewed interest in not-for-profits because these organizations are formed to improve communities and change lives. For example, Habitat for Humanity is a not-for-profit corporation and was formed to provide homes for qualified lower income people who cannot afford housing. Even though this corporation may receive more money than it spends, any surplus funds are "reinvested" in building activities to provide low-cost housing to qualified individuals. Other examples of not-for-profit corporations include the SeaWorld and Busch Gardens Conservation Fund, the Girl Scouts, the Bill and Melinda Gates Foundation, and many local not-for-profits designed to meet specific needs within a community.

From a career standpoint, you should realize that many not-for-profit corporations operate in much the same way as a for-profit business. While many not-for-profit corporations rely on volunteers to perform services, larger organizations do have paid employees. These employees are responsible for making sure the not-for-profit corporation achieves its goals and objectives, ensuring accountability for finances and donations, and monitoring activities to improve performance of both paid employees and volunteers. If interested in a career in the non-profit sector, why not volunteer your time and effort in a local not-for-profit organization to see if you enjoy this type of challenge.

Table 4.4 Some Advantages and Disadvantages of a Regular Corporation, S-Corporation, and Limited-Liability Company

	Regular C-Corporation	S-Corporation	Limited-Liability Company
Double taxation	Yes	No	No
Limited liability and personal asset protection	Yes	Yes	Yes
Management and ownership flexibility	No	No	Yes
Restrictions on the number of owners/stockholders	No	Yes	No
Internal Revenue Service tax regulations	Many	Many	Fewer

not-for-profit corporation a corporation organized to provide a social, educational, religious, or other service rather than to earn a profit

Career
SUCCESS

Choosing a Career in Not-for-Profit Corporations

If you're looking to make a difference, consider a career in the world of not-for-profit corporations. Such organizations exist to offer social, educational, religious, or other services, rather than striving for profitability. Although employees may receive lower salaries than they would in for-profit businesses, many find not-for-profit corporations rewarding places to develop their personal and professional skills.

Ginny Wiedower, who graduated from the University of Central Arkansas with a B.A. in public relations and writing, worked for several businesses before joining Goodwill Industries of Arkansas in Little Rock as director of marketing and communications. Goodwill helps low-income and disabled people improve their situations through job training and employment opportunities.

"Goodwill is the first non-profit [not-for-profit] that I've worked for," Ginny says, "and during my time here I've realized that this is really where I want to be, in the non-profit sector." She likes being able to help people "grow and really reach their highest potential." Now Ginny's career goal is to become the executive director of a local not-for-profit corporation.

© Michael Ventura/Alamy

Thousands of college graduates have chosen careers in education after being trained by the not-for-profit corporation Teach for America. For example, once Boston College graduate Kilian Betlach completed his training, he taught in a California middle school and then joined a not-for-profit policy group that works to improve the U.S. education system. Is a career in the not-for-profit sector in your future?

Sources: Jeff Hankins, "The New Influentials in Their 20s," *Arkansas Business,* November 9, 2009, 18ff; Amanda Paulson, "The Approach of Teach for America," *Christian Science Monitor,* March 27, 2009, http://www.csmonitor.com/USA/Education/2009/0327/p13s02-ussc.html; Kate Stanton and Lizzy Berryman, "New Grads Increasingly Turning to Jobs in Service, Volunteer Sectors," *PBS Online NewsHour,* March 16, 2009, http://www.pbs.org/newshour/updates/business/jan-june09/service_03-16.html.

7

Discuss the purpose of a cooperative, joint venture, and syndicate.

Cooperatives, Joint Ventures, and Syndicates

Today, three additional types of business organizations—cooperatives, joint ventures, and syndicates—are used for special purposes. Each of these forms of organization is unique when compared with more traditional forms of business ownership.

Cooperatives

A **cooperative** is an association of individuals or firms whose purpose is to perform some business function for its members. The cooperative can perform its function more effectively than any member could by acting alone. For example, cooperatives purchase goods in bulk and distribute them to members; thus, the unit cost is lower than it would be if each member bought the goods in a much smaller quantity.

Although cooperatives are found in all segments of our economy, they are most prevalent in agriculture. Farmers use cooperatives to purchase supplies, to buy services such as trucking and storage, and to process and market their products. Ocean Spray Cranberries, Inc., for example, is a cooperative of some 600 cranberry growers and about 50 citrus growers spread throughout the country.[11]

cooperative an association of individuals or firms whose purpose is to perform some business function for its members

Joint Ventures

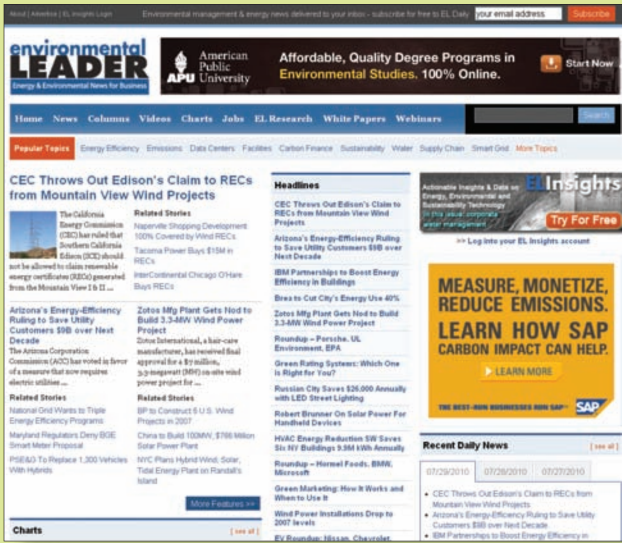
A **joint venture** is an agreement between two or more groups to form a business entity in order to achieve a specific goal or to operate for a specific period of time. Both the scope of the joint venture and the liabilities of the people or businesses involved usually are limited to one project. Once the goal is reached, the period of time elapses, or the project is completed, the joint venture is dissolved.

Corporations, as well as individuals, may enter into joint ventures. Major oil producers often have formed a number of joint ventures to share the extremely high cost of exploring for offshore petroleum deposits. And many U.S. companies are forming joint ventures with foreign firms in order to enter new markets around the globe. For example, Walmart has joined forces with India's Bharti Enterprises to establish wholesale cash-and-carry stores that sell directly to local retailers in different cities and towns in India. Plans are for each store to offer an assortment of approximately 6,000 items including food and nonfood items at competitive wholesale prices, allowing retailers and small business owners to lower their cost of operation. The first cash-and-carry store was named Best Price Modern Wholesale and opened in Amritsar, India, in May 2009. Over the next seven years, the joint venture plans to open 10 to 15 cash-and-carry stores that will employ approximately 5,000 people.[12]

Sustaining the Planet

Get Your Daily Dose of Sustainability News

What steps are small businesses, major corporations, and not-for-profit corporations worldwide taking to achieve a more sustainable and earth-friendly future? Find out by clicking to get your daily dose of sustainability news, analysis, and videos at the *Environmental Leader* Web site. Take a look: http://www.environmentalleader.com.



Syndicates

A **syndicate** is a temporary association of individuals or firms organized to perform a specific task that requires a large amount of capital. The syndicate is formed because no one person or firm is willing to put up the entire amount required for the undertaking. Like a joint venture, a syndicate is dissolved as soon as its purpose has been accomplished.

Syndicates are used most commonly to underwrite large insurance policies, loans, and investments. To share the risk of default, banks have formed syndicates to provide loans to developing countries. Stock brokerage firms usually join together in the same way to market a new issue of stock. For example, three Wall Street firms—Bank of America, JPMorgan Chase & Co., and Goldman Sachs—formed a syndicate to sell shares of stock in Symetra—a Washington-based insurance company. With the help of the syndicate, Symetra was able to raise $365 million in 2010.[13] (An *initial public offering* is the term used to describe the first time a corporation sells stock to the general public.)

joint venture an agreement between two or more groups to form a business entity in order to achieve a specific goal or to operate for a specific period of time

syndicate a temporary association of individuals or firms organized to perform a specific task that requires a large amount of capital

Corporate Growth

8

Explain how growth from within and growth through mergers can enable a business to expand.

Growth seems to be a basic characteristic of business. One reason for seeking growth has to do with profit: A larger firm generally has greater sales revenue and thus greater profit. Another reason is that in a growing economy, a business that does not grow is actually shrinking relative to the economy. A third reason is that business growth is a means by which some executives boost their power, prestige, and reputation.

Growth poses new problems and requires additional resources that first must be available and then must be used effectively. The main ingredient in growth is capital—and as we have noted, capital is most readily available to corporations.

A tasty partnership for growth. When Starbucks formed a partnership with All Nippon Airways, passengers were delighted. In this photo, Starbucks Chairperson and CEO Howard Schultz shakes hands with Shinichiro Ito, Chairperson of the Japanese air carrier. This partnership is good for both firms. Simply put: Starbucks sells more product and obtains more brand recognition; All Nippon Airways adds another perk to enhance the customer's travel experience.

© AFP PHOTO / Yoshikazu TSUNO/Newscom

Growth from Within

Most corporations grow by expanding their present operations. Some introduce and sell new but related products. Others expand the sale of present products to new geographic markets or to new groups of consumers in geographic markets already served. Although Walmart was started by Sam Walton in 1962 with one discount store, today Walmart has over 8,400 stores in the United States and 14 other countries and has long-range plans for expanding into additional international markets.[14]

Growth from within, especially when carefully planned and controlled, can have relatively little adverse effect on a firm. For the most part, the firm continues to do what it has been doing, but on a larger scale. For instance, Larry Ellison, co-founder and CEO of Oracle Corporation of Redwood Shores, California, built the firm's annual revenues up from a mere $282 million in 1988 to approximately $23 billion today.[15] Much of this growth has taken place over the last ten years as Oracle capitalized on its global leadership in information management software.

Growth Through Mergers and Acquisitions

Another way a firm can grow is by purchasing another company. The purchase of one corporation by another is called a **merger**. An *acquisition* is essentially the same thing as a merger, but the term usually is used in reference to a large corporation's purchases of other corporations. Although most mergers and acquisitions are friendly, hostile takeovers also occur. A **hostile takeover** is a situation in which the management and board of directors of a firm targeted for acquisition disapprove of the merger.

When a merger or acquisition becomes hostile, a corporate raider—another company or a wealthy investor—may make a tender offer or start a proxy fight to gain control of the target company. A **tender offer** is an offer to purchase the stock of a firm targeted for acquisition at a price just high enough to tempt stockholders to sell their shares. Corporate raiders also may initiate a proxy fight. A **proxy fight** is a technique used to gather enough stockholder votes to control a targeted company.

If the corporate raider is successful and takes over the targeted company, existing management usually is replaced. Faced with this probability, existing management may take specific actions, sometimes referred to as "poison pills," "shark repellents," or "porcupine provisions," to maintain control of the firm and avoid the hostile takeover. Whether mergers are friendly or hostile, they are generally classified as *horizontal, vertical,* or *conglomerate* (see Figure 4.5).

merger the purchase of one corporation by another

hostile takeover a situation in which the management and board of directors of a firm targeted for acquisition disapprove of the merger

tender offer an offer to purchase the stock of a firm targeted for acquisition at a price just high enough to tempt stockholders to sell their shares

proxy fight a technique used to gather enough stockholder votes to control a targeted company

Horizontal Mergers

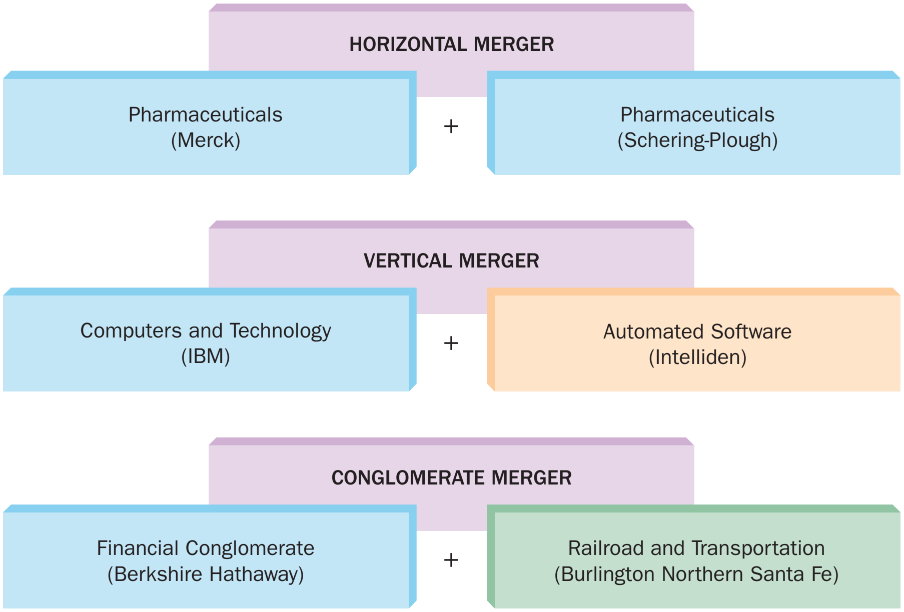
A *horizontal merger* is a merger between firms that make and sell similar products or services in similar markets. The merger between Merck and Schering-Plough is an example of a horizontal merger because both firms are in the pharmaceutical industry. This type of merger tends to reduce the number of firms in an industry—and thus may reduce competition. Most horizontal mergers are reviewed carefully by federal agencies before they are approved in order to protect competition in the marketplace.

Vertical Mergers

A *vertical merger* is a merger between firms that operate at different but related levels in the production and marketing of a product. Generally, one

Figure 4.5 Three Types of Growth by Merger

Today, mergers are classified as horizontal, vertical, or conglomerate.



of the merging firms is either a supplier or a customer of the other. A vertical merger occurred when IBM acquired Intelliden. At the time of the 2010 merger, Intelliden, a privately held company based in Menlo Park, California, was a leading provider of intelligent network automation software that enables organizations to manage their computer systems and network services. By acquiring Intelliden's automation software technology, IBM will be able to help clients improve network service availability and reduce errors and downtime for its customers. Rather than develop its own automated software, IBM simply purchased the Intelliden company.[16]

Conglomerate Mergers A *conglomerate merger* takes place between firms in completely different industries. One of the largest conglomerate mergers in recent history occurred when Berkshire Hathaway acquired Burlington Northern Santa Fe Railway. While both companies were recognized as successful companies that have a history of increasing sales revenues and profits, they operate in different industries. The Berkshire Hathaway–Burlington Northern Santa Fe merger was friendly because it was beneficial for both firms.

Merger and Acquisition Trends During an Economic Crisis

While there have always been mergers and acquisitions, the recent economic crisis has changed the dynamics of how and why firms merge. Recently, mergers and acquisitions have been fueled by the desire of financially secure firms to take over firms in financial trouble. For a firm experiencing financial difficulties, a merger or acquisition is often a better option than bankruptcy. During the recent economic crisis, this trend was especially evident in the financial services and banking industry. For example, Wachovia was purchased by Wells Fargo in order to avoid a Wachovia bank failure or a government takeover of Wachovia's assets and loan portfolio. In other cases, the FDIC and the Comptroller of the Currency seized bank assets and sold them to the highest bidder. Bank seizure by the federal government is important because it provides a way for the government to step in and protect depositors from a bank failure.

In other situations, a financially secure firm will purchase a company experiencing financial problems because it is a good investment. Consider why Bank of America acquired Merrill Lynch. Merrill Lynch's survival as a viable company was threatened because of mounting dollar losses from mortgage defaults the firm experienced during the economic crisis. In just one week, the value of Merrill's stock shares dropped over 35 percent. And there was talk of a possible bankruptcy. On the other hand, Bank of America was relatively strong because its core consumer banking business remained healthy. Bank of America was already the nation's largest retail bank, credit card company, and mortgage lender. With the $50 billion acquisition of Merrill Lynch, it also became the nation's largest retail brokerage firm—a goal Bank of America had been trying to achieve on its own for years.[17]

Economists, financial analysts, corporate managers, and stockholders still hotly debate whether mergers and acquisitions are good for the economy—or for individual companies—in the long run. Takeover advocates argue that for companies that have been taken over, the purchasers have been able to make the company more profitable and productive by installing a new top-management team, by reducing expenses, and by forcing the company to concentrate on one main business.

Takeover opponents argue that takeovers do nothing to enhance corporate profitability or productivity. These critics argue that threats of takeovers have forced managers to devote valuable time to defending their companies from takeover. Finally, the opposition argues that the only people who benefit from takeovers are investment bankers, brokerage firms, and takeover "artists," who receive financial rewards by manipulating corporations rather than by producing tangible products or services.

Most experts now predict that mergers and acquisitions after the economic crisis will be the result of cash-rich companies looking to acquire businesses that will enhance their position in the marketplace. Analysts also anticipate more mergers that involve companies or investors from other countries. Regardless of the companies involved or where the companies are from, future mergers and acquisitions will be driven by solid business logic and the desire to compete in the international marketplace.

Whether they are sole proprietorships, partnerships, corporations, or some other form of business ownership, most U.S. businesses are small. In the next chapter, we focus on these small businesses. We examine, among other things, the meaning of the word *small* as it applies to business and the place of small business in the American economy.

return to inside business

MINT.COM

Aaron Patzer didn't set out to become a multimillionaire when he founded Mint.com. He was filling a need by offering a quick and easy way for consumers to manage their money. When Intuit made an acquisition offer, Patzer deliberated for months and finally agreed to sell. Intuit paid $170 million for Mint.com and, as part of the deal, invited Patzer to head its personal finance division, including the Quicken software and Web site. All of Mint.com's employees were offered jobs with Intuit, and all accepted.

Backed by Intuit's strength and resources, Patzer is currently applying his entrepreneurial skills to the challenge of growing his division. What does it feel like to be a senior executive in a major corporation rather than the founder of a start-up corporation? "I now have one boss as opposed to the five bosses I had on the board of directors before, and all the investors," he says.

Questions

1. Is Intuit's acquisition of Mint.com a horizontal, vertical, or conglomerate merger? How do you know?
2. What does Aaron Patzer mean when he says that at Intuit he has one boss, whereas at Mint .com, his bosses were the board of directors and all the investors?

SUMMARY

Summary

1 Describe the advantages and disadvantages of sole proprietorships.

In a sole proprietorship, all business profits become the property of the owner, but the owner is also personally responsible for all business debts. A successful sole proprietorship can be a great source of pride for the owner. When comparing different types of business ownership, the sole proprietorship is the simplest form of business to enter, control, and leave. It also pays no special taxes. Perhaps for these reasons, 71 percent of all American business firms are sole proprietorships. Sole proprietorships nevertheless have disadvantages, such as unlimited liability and limits on one person's ability to borrow or to be an expert in all fields. As a result, this form of ownership accounts for only 4 percent of total revenues when compared with partnerships and corporations.

2 Explain the different types of partners and the importance of partnership agreements.

Like sole proprietors, general partners are responsible for running the business and for all business debts. Limited partners receive a share of the profit in return for investing in the business. However, they are not responsible for business debts beyond the amount they have invested. It is also possible to form a master limited partnership (MLP) and sell units of ownership to raise capital. Regardless of the type of partnership, it is always a good idea to have a written agreement (or articles of partnership) setting forth the terms of a partnership.

3 Describe the advantages and disadvantages of partnerships.

Although partnership eliminates some of the disadvantages of sole proprietorship, it is the least popular of the major forms of business ownership. The major advantages of a partnership include ease of start-up, availability of capital and credit, personal interest, combined skills and knowledge, retention of profits, and possible tax advantages. The effects of management disagreements are one of the major disadvantages of a partnership. Other disadvantages include unlimited liability (in a general partnership), lack of continuity, and frozen investment. By forming a limited partnership, the disadvantage of unlimited liability may be eliminated for the limited partner(s). This same disadvantage may be eliminated for partners that form a limited-liability partnership (LLP). Of course, special requirements must be met if partners form either the limited partnership or the limited-liability partnership.

4 Summarize how a corporation is formed.

A corporation is an artificial person created by law, with most of the legal rights of a real person, including the right to start and operate a business, to own property, to borrow money, to be sued or sue, and to enter into contracts. With the corporate form of ownership, stock can be sold to individuals to raise capital. The people who own a corporation's stock—and thus own part of the corporation—are called stockholders. Generally, corporations are classified as closed corporations (few stockholders) or open corporations (many stockholders).

The process of forming a corporation is called incorporation. Most experts believe that the services of a lawyer are necessary when making decisions about where to incorporate and about obtaining a corporate charter, issuing stock, holding an organizational meeting, and all other legal details involved in incorporation. In theory, stockholders are able to control the activities of the corporation because they elect the board of directors who appoint the corporate officers.

5 Describe the advantages and disadvantages of a corporation.

Perhaps the major advantage of the corporate form is limited liability—stockholders are not liable for the corporation's debts beyond the amount they paid for its stock. Other important advantages include ease of raising capital, ease of transfer of ownership, perpetual life, and specialized management. A major disadvantage of a large corporation is double taxation: All profits are taxed once as corporate income and again as personal income because stockholders must pay a personal income tax on the profits they receive as dividends. Other disadvantages include difficulty and expense of formation, government regulation, conflict within the corporation, and lack of secrecy.

6 Examine special types of corporations, including S-corporations, limited-liability companies, and not-for-profit corporations.

S-corporations are corporations that are taxed as though they were partnerships but that enjoy the benefit of limited liability. To qualify as an S-corporation, a number of criteria must be met. A limited-liability company (LLC) is a form of business ownership that provides limited liability and has fewer restrictions. LLCs with at least two members are taxed like a partnership and thus avoid the double taxation imposed on most corporations. LLCs with just one member are taxed like a sole proprietorship. When compared with a regular corporation or an S-corporation, an LLC is more flexible. Not-for-profit corporations are formed to provide social services and to improve communities and change lives rather than to earn profits.

7 Discuss the purpose of a cooperative, joint venture, and syndicate.

Three additional forms of business ownership—the cooperative, joint venture, and syndicate—are used by their owners to meet special needs. A cooperative is an association of individuals or firms whose purpose is to perform some business function for its members. A joint venture is formed when two or more groups form a business entity in order to achieve a specific goal or to operate for a specific period of time. Once the goal is reached, the period of time elapses, or the project is completed, the joint venture is dissolved. A syndicate is a temporary association of individuals or firms organized to perform a specific task that requires large amounts of capital. Like a joint venture, a syndicate is dissolved as soon as its purpose has been accomplished.

8 Explain how growth from within and growth through mergers can enable a business to expand.

A corporation may grow by expanding its present operations or through a merger or an acquisition. Although most mergers are friendly, hostile takeovers also occur. A hostile takeover is a situation in which the management and board of directors of a firm targeted for acquisition disapprove of the merger. Mergers generally are classified as horizontal, vertical, or conglomerate.

During the recent economic crisis, mergers and acquisitions have been fueled by the desire of financially secure firms to take over firms in financial trouble. For a firm experiencing financial trouble, a merger or acquisition is often a better option than bankruptcy. In other situations, a financially secure firm will purchase a company experiencing financial problems because it is a good investment.

While economists, financial analysts, corporate managers, and stockholders debate the merits of mergers, some trends should be noted. First, experts predict that future mergers will be the result of cash-rich companies looking to acquire businesses that will enhance their position in the marketplace. Second, more mergers are likely to involve foreign companies or investors. Third, mergers will be driven by business logic and the desire to compete in the international marketplace.

Key Terms

You should now be able to define and give an example relevant to each of the following terms:

sole proprietorship (108)
unlimited liability (110)
partnership (111)
general partner (112)
limited partner (112)
master limited partnership (MLP) (112)
corporation (116)
stock (116)
stockholder (116)
closed corporation (117)
open corporation (117)
domestic corporation (118)
foreign corporation (118)
alien corporation (118)
common stock (118)
preferred stock (118)
dividend (118)
proxy (118)
board of directors (119)
corporate officers (119)
limited liability (120)
S-corporation (122)
limited-liability company (LLC) (122)
not-for-profit corporation (123)
cooperative (124)
joint venture (125)
syndicate (125)
merger (126)
hostile takeover (126)
tender offer (126)
proxy fight (126)

Review Questions

1. What is a sole proprietorship? What are the major advantages and disadvantages of this form of business ownership?
2. How does a partnership differ from a sole proprietorship? Which disadvantages of sole proprietorship does the partnership tend to eliminate or reduce?
3. What is the difference between a general partner and a limited partner?
4. What issues should be included in a partnership agreement? Why?
5. Explain the difference between
   a. an open corporation and a closed corporation.
   b. a domestic corporation, a foreign corporation, and an alien corporation.
6. Outline the incorporation process, and describe the basic corporate structure.
7. What rights do stockholders have?
8. What are the primary duties of a corporation's board of directors? How are directors selected?
9. What are the major advantages and disadvantages associated with the corporate form of business ownership?
10. How do an S-corporation and a limited-liability company differ?
11. Explain the difference between a regular corporation and a not-for-profit corporation.
12. Why are cooperatives formed? Explain how they operate.
13. In what ways are joint ventures and syndicates alike? In what ways do they differ?
14. What is a hostile takeover? How is it related to a tender offer and a proxy fight?
15. Describe the three types of mergers.

Discussion Questions

1. If you were to start a business, which ownership form would you choose? What factors might affect your choice?
2. Why might an investor choose to become a partner in a limited-liability partnership (LLP) business instead of purchasing the stock of an open corporation?
3. Discuss the following statement: "Corporations are not really run by their owners."
4. What kinds of services do not-for-profit corporations provide? Would a career in a not-for-profit corporation appeal to you?
5. Is growth a good thing for all firms? How does management know when a firm is ready to grow?

Video Case 4.1

Annie's Homegrown: A Corporation with Entrepreneurial Spirit

When Annie Withey's first husband suggested she create a snack food to go into the resalable bag he'd invented, the 21-year-old newlywed developed an all-natural, cheddar cheese-flavored popcorn. The bag never made it to market, but Annie's popcorn, called Smartfood, became one of the fastest-selling snack foods in U.S. history. In fact, in 1989 PepsiCo Inc's Frito-Lay division bought the brand for about $15 million.

Annie, an organic farmer and mother of two children, cashed out stock worth $1 million and created the all-natural white-cheddar macaroni and cheese product she had been thinking about for some time. She and her husband initially marketed it by knocking on supermarket doors and canvassing ski lodges, outdoor folk concerts, store parking lots, and wherever people gathered. Thus Annie's Homegrown, a pioneering entrepreneurial company in the natural and organic food industry, was born.

This venture was also a success for Annie, and even though her firm has gone on to become part of a larger conglomerate, Annie remains the entrepreneurial heart of the brand. "I learned a lot and took a lot with me," says Annie of her early experience running the operation. Now she delegates day-to-day management, as well as public appearances, to others, and concentrates on what she does best—creating new recipes and providing inspiration to her co-workers. Being a public figure? "That's just not me," she says. "I'm not very good at making presentations and selling," she feels.

Annie's Homegrown offers 80 natural and organic pasta and canned products, as well as snack crackers and a microwaveable version of its now-famous macaroni and cheese, designed for college dorm room convenience. Its products are found in Costco and Target, as well as in 18,000 grocery and 6,000 natural food stores nationwide. Yet Annie's still has only about 3 percent of the macaroni and cheese market compared with the leader, Kraft, which has 80 percent.

"We could never compete directly," says CEO John Foraker. "We appeal to a consumer who is less price conscious and willing to pay more to feel good about what they eat." Because Annie's mac and cheese also costs 30 percent more than Kraft's, the company's marketing focuses on product attributes. The nation's leading brand of organic and natural pasta meals and snacks, Annie's Homegrown represents what *Customer Relationship Magazine* calls "an unmistakable shift toward organic products, green marketing, and sustainability efforts." Annie's story, well known to many of the company's customers, also helps build loyalty to the company's brands.

But for Annie Withey, becoming successful meant taking some risks. Annie had to personally guarantee all loans to her company early on. "Your entire career and reputation are on the line," says company president Paul Nardone. But Annie has always trusted her instincts, and events have usually proven her right. She is "our moral compass," says Nardone, and a continuing inspiration. By 1998 a capital infusion from two small food companies, Consorzio and Fantastic Foods, was helping fuel growth, but choosing the right investment company would become critical to the company's long-term expansion goals.

CEO Foraker says Solera Capital LLC, a $250 million private-equity firm run by women, was looking to enter the fast-growing organic food market and took a majority stake in the company with an initial $20 million investment in 2002. "It's a perfect fit," says Molly Ashby, Solera's chief executive officer. It's a great brand, very authentic, with tremendous crossover into both mainstream and natural markets. The remaining interest in the company is held by Withey, current management, and a small group of founding investors. Solera recently bought Consorzio and Fantastic Foods and combined them with Annie's Homegrown to form Homegrown Naturals Inc., based in Napa, California.

As founder, Annie Withey has assumed the role of "inspirational president." She still writes the text on every product box, and Bernie the Bunny, inspired by her brother's illustration, still appears on every package. As she continues to fill the role of creative leader of the company she started, Annie has been described as its "quality gatekeeper" and a humble person whose creative instincts are "right on." When customers write or e-mail to suggest new products, each idea is still considered, and the "real" Annie never gets tired of hearing how much people enjoy her products.[18]

Questions

1. What personal traits does Annie Withey exhibit that entrepreneurs need to succeed? How have her personal characteristics helped shape the success of her business?
2. How did the company evolve from a small business into a multimillion dollar leader in the natural organic food industry? What long-term growth strategies is the company pursuing as it moves into the future?
3. Explore Annie's Web site at http://www.annies.com. What unique features did you find? How does this Web site support Annie's mission?

Case 4.2 The Conglomerate Success of Berkshire Hathaway

When Warren Buffett started his first partnership more than 50 years ago, he never dreamed he would wind up putting together a wildly diverse collection of businesses under one corporate umbrella. Originally, Buffett set up a series of partnerships with family and friends to pool cash for buying big blocks of stock in companies he had researched. Not all of Buffett's stock picks paid off, but many were so successful that Buffett quickly earned a worldwide reputation for savvy investing.

Always looking for a good investment, Buffett turned his attention to the prospects of Berkshire Hathaway, a struggling textile manufacturer based in New Bedford, Massachusetts. Seeing value in the company's heritage and its plans for making synthetic fibers, Buffett began buying its stock. Once he controlled the mills, Buffett put one of Berkshire Hathaway's executives in charge. This was Buffett's pattern over and over as he built a conglomerate by adding to his company's portfolio of businesses. He provided the financial backing, but he didn't meddle in the day-to-day management decisions of the corporations he purchased.

Berkshire Hathaway became the corporate vehicle through which Buffett acquired a variety of companies. In the early days, he pursued insurance firms, banks, and publishing companies. He continued buying year after year, adding See's Candies to his conglomerate and, later, GEICO insurance, sticking to his tried-and-true formula of investing in companies with long-term profit potential and strong competitive positions.

Living in Omaha, Buffett couldn't help but notice the success of the Nebraska Furniture Mart, a superstore that annually sold $100 million worth of furniture. The family-owned business was a fierce competitor and a major regional power in furniture retailing. Although Buffett had tried, unsuccessfully, to buy the store, he never gave up. During the 1980s, he again approached the retailer. This time he pointed out all the financial benefits of being part of Berkshire Hathaway and emphasized his hands-off approach to ownership. Berkshire Hathaway won the deal.

Today Berkshire Hathaway has more than six dozen companies in its diverse portfolio. Although it still owns some of the companies it acquired decades ago, the portfolio has changed a bit over the years. GEICO, the third-largest U.S. auto insurance firm, has been a member of the conglomerate since 1996. Berkshire Hathaway also owns the General Re insurance firm. Among the retailing businesses it owns are Jordan Furniture, Star Furniture, Helzberg Diamond Shops, and the Pampered Chef direct-seller of kitchen tools. In addition, it owns the ice-cream franchising company Dairy Queen; Benjamin Moore paint; Johns Manville building products; and Shaw Industries, which makes tufted broadloom carpeting.

Berkshire Hathaway has expanded into transportation, as well. Its NetJets was a pioneer in offering companies and individuals the opportunity to own a fraction of a private jet, so they can enjoy the convenience of flying whenever and wherever they want. In 2009, the conglomerate paid $26 billion for Burlington Northern Santa Fe Corp., a railroad that serves western and southwestern states. This acquisition, labeled "brilliant" by a railway competitor because it was completed just as the industry began to rebound from recession, gave Buffett access to years of details about the size, volume, and destination of train shipments. By analyzing this information, Buffett spotted clues that helped him fine-tune his investments.

The annual meeting held by Berkshire Hathaway is unlike any stockholder gathering on Earth. The more-than-35,000 people in attendance spend hours browsing and buying from exhibits set up by the conglomerate's companies. Stockholders are encouraged to bring the details of their car insurance and let GEICO give them quotes on the spot, including a small ownership discount. Nebraska Furniture Mart promotes a special stockholders' weekend of sales, as do other Berkshire Hathaway-owned retailers in the area. The annual meeting is such a high-profile event that it merits coverage by the *New York Times,* CNBC, and *Fortune* magazine, among many other major media outlets. What will Berkshire Hathaway's next acquisition target be?[19]

Questions

1. Why would Berkshire Hathaway own a number of furniture retailers? Outline the possible advantages and disadvantages.
2. Do you think Berkshire Hathaway should allow stockholders to suggest or vote on potential acquisitions via proxy or at the annual meeting? Why or why not?
3. How much influence are Berkshire Hathaway's stockholders likely to have (or want) over the management of the conglomerate or one of the conglomerate's companies? Explain.

Building Skills for Career Success

1 JOURNALING FOR SUCCESS

Today, many people work for a sole proprietorship, partnership, or corporation. Still others decide to become entrepreneurs and start their own business.

Assignment

1. Assume that you are now age 25 and have graduated from college. Would you prefer to work in someone else's business or one that you would start? Explain your answer.
2. Assuming that you have decided to start your own small business, what special skills and experience will you need to be successful? (*Note:* You may want to talk with someone who owns a business before answering this question.)
3. Now describe where and how you could obtain the skills and experience you need to be successful.
4. What type of business ownership would you choose for your business?

2 EXPLORING THE INTERNET

Arguments about mergers and acquisitions often come down to an evaluation of who benefits and by how much. Sometimes the benefits include access to new products, talented management, new customers, or new sources of capital. Often, the debate is complicated by the involvement of firms based in different countries.

The Internet is a fertile environment for information and discussion about mergers. The firms involved will provide their view about who will benefit and why it is either a good thing or not. Journalists will report facts and offer commentary as to how they see the future result of any merger, and of course, chat rooms located on the Web sites of many journals promote discussion about the issues. Visit the text Web site for updates to this exercise.

Assignment

1. Using an Internet search engine such as Google or Yahoo!, locate two or three sites providing information about a recent merger (use a keyword such as *merger* or *acquisition*).
2. After examining these sites and reading journal articles, report information about the merger, such as the dollar value, the reasons behind the merger, and so forth.
3. Based on your assessment of the information you have read, do you think the merger is a good idea or not for the firms involved, the employees, the investors, the industry, and society as a whole? Explain your reasoning.

3 DEVELOPING CRITICAL-THINKING SKILLS

Suppose that you are a person who has always dreamed of owning a business but never had the money to open one. Since you were old enough to read a recipe, your mother allowed you to help in the kitchen. Most of all, you enjoyed baking and decorating cakes. You liked using your imagination to create cakes for special occasions. By the time you were in high school, you were baking and decorating wedding cakes for a fee. Also assume that after high school you started working full time as an adjuster for an insurance company. Your schedule now allows little time for baking and decorating cakes. Finally, assume that you inherited $250,000 and that changes at your job have created undue stress in your life. What should you do?

Assignment

1. Discuss the following points:
   a. What career options are available to you?
   b. If you decide to open your own business, what form of ownership would be best for your business?
   c. What advantages and disadvantages apply to your preferred form of business ownership?
2. Prepare a two-page report summarizing your findings.

4 BUILDING TEAM SKILLS

Using the scenario in Exercise 3, suppose that you have decided to quit your job as an insurance adjuster and open a bakery. Your business is now growing, and you have decided to add a full line of catering services. This means more work and responsibility. You will need someone to help you, but you are undecided about what to do. Should you hire an employee or find a partner? If you add a partner, what type of decisions should be made to create a partnership agreement?

Assignment

1. In a group, discuss the following questions:
   a. What are the advantages and disadvantages of adding a partner versus hiring an employee?
   b. Assume that you have decided to form a partnership. What articles should be included in a partnership agreement?
   c. How would you go about finding a partner?
2. Summarize your group's answers to these questions, and present them to your class.
3. As a group, prepare an articles-of-partnership agreement. Be prepared to discuss the pros and cons of your group's agreement with other groups from your class, as well as to examine their agreements.

5 RESEARCHING DIFFERENT CAREERS

Many people spend their entire lives working in jobs that they do not enjoy. Why is this so? Often, it is because they have taken the first job they were offered without giving it much thought. How can you avoid having this happen to you? First, you should determine your "personal profile" by identifying and analyzing your own strengths, weaknesses, things you enjoy, and things you dislike. Second, you should identify the types of jobs that fit your profile. Third, you should identify and research the companies that offer those jobs.

Assignment

1. Take two sheets of paper and draw a line down the middle of each sheet, forming two columns on each page. Label column 1 "Things I Enjoy or Like to Do," column 2 "Things I Do Not Like Doing," column 3 "My Strengths," and column 4 "My Weaknesses."
2. Record data in each column over a period of at least one week. You may find it helpful to have a relative or friend give you input.
3. Summarize the data, and write a profile of yourself.
4. Take your profile to a career counselor at your college or to the public library and ask for help in identifying jobs that fit your profile. Your college may offer testing to assess your skills and personality. The Internet is another resource.
5. Research the companies that offer the types of jobs that fit your profile.
6. Write a report on your findings.