Chapter 8 – Business Organizations

Section One – Sole Proprietorships

OBJECTIVES

- Explain the characteristics of sole proprietorships.
- Analyze the advantages of a sole proprietorship.
- Analyze the disadvantages of a sole proprietorship.

The Main Idea:

A business is an economic institution that seeks a profit by allocating resources to satisfy customers. Sole proprietorships are the most common form of business in the United States. They are easy to establish and offer owners both the benefits and drawbacks that come with full control of a business.

A *business organization* is an establishment formed to carry on commercial enterprise.

- A business organization is a company or firm.

A *sole proprietorship* is a business owned and managed by a single individual (Entrepreneur).

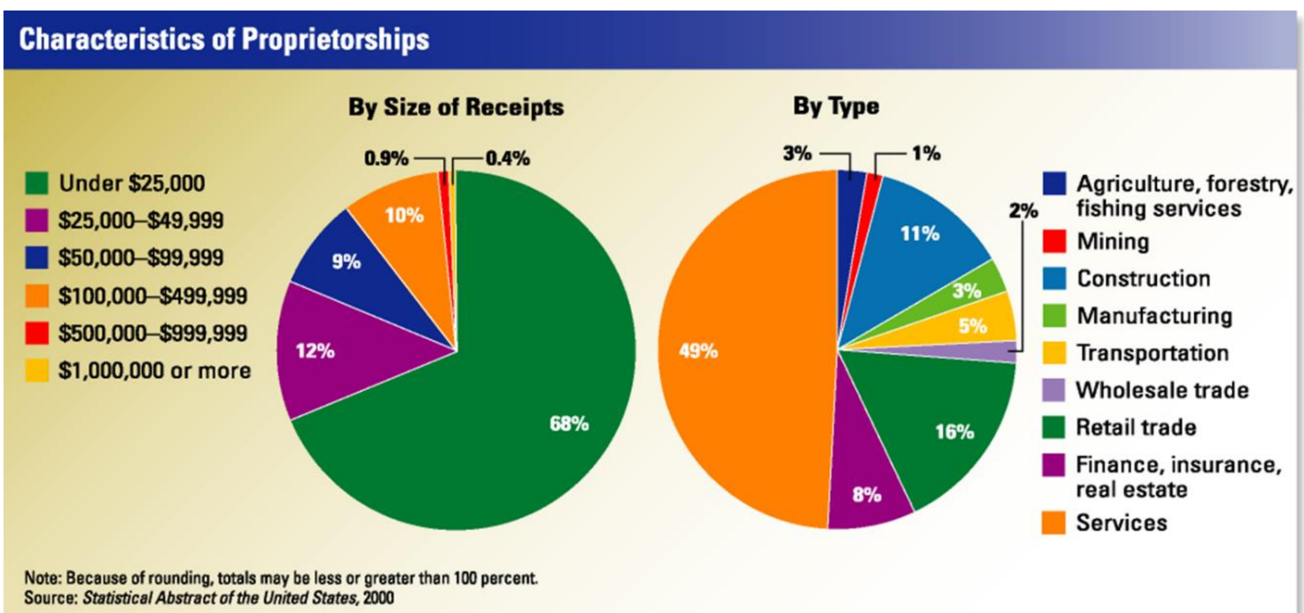
- Earns all of the business' profits and is responsible for all of its debts.

Sole proprietorships make up about 75% of all businesses.

Most sole proprietorships are small.

- All together, sole proprietorships generate only about 6 %of all sales.

Look around Salem – which local businesses are sole proprietorships?



What are the advantages of sole proprietorship?

1. **A sole proprietorship is simple to establish.**

   Minimum requirements:
   a. *Authorization* – must obtain a business license from local (city) government, or other licenses from the state government.
   b. *Site permit* – must obtain a certificate of occupancy (if not operating out of your own home) to use another building for business.
   c. *Name* – must register a business name.
2. **A proprietorship is the least-regulated form of business organization.**
   1. Industry-specific regulations (ex. Health codes for restaurants).
   2. Zoning laws – cities and towns designate separate areas (zones) for residential use, industrial use, and business use.
   3. Few legal requirements – less paperwork

3. **The owner gets to keep all the profits after paying income taxes.**
   - This is the MAJOR motivation behind starting a small business. – don't have to share success!
4. **Full control – Sole proprietors run their business as they wish.**
   - One reason why they can respond to changes in the marketplace so quickly.
   - A high degree of freedom – fast flexible decision-making - "your own boss"
5. **Easy to discontinue**
   - If sole proprietors decide to stop operations and do something else, they can do so easily.
   - Must pay all debts and taxes FIRST – Must fulfill all legal obligations

It takes a certain type of personality to start up a business.

What is the "entrepreneurial spirit?"

Entrepreneurs…

- Seek out responsibility
- Are willing to take risks
- Believe in themselves
- Desire to reach their full potentials
- Have high energy levels
- Are upbeat and optimistic
- Look toward the future rather than the past
- Value achievement over money
- Maintain flexibility as they face new challenges
- Are strongly committed to their goals

Timed write (4 minutes): Describe some times when you exhibited "entrepreneurial spirit."

<u>What are the disadvantages of sole proprietorship?</u>

1. **Unlimited *personal liability* - the legally bound obligation to pay debts.**
    - Sole proprietors are fully and personally responsible for all their business debts – can ruin a sole proprietor's personal finances.
2. **Limited access to resources.**
    - If you have to expand, you will pay for the expansion out of your own pocket.
    - Many small business owners use all of their personal savings (and take out loans) to start their business.
    - Sole proprietors might lack the human capital – the skills, knowledge and abilities – to succeed.
3. **Lack of permanence – the business ceases to exist if a sole proprietor dies or closes up shop due to retirement, illness, loss of interest in the business or for another reason.**
    - Fringe benefits – payment other than wages or salaries (paid vacation, health insurance, etc..)

Section 2 – Partnerships

OBJECTIVES

- Compare and contrast the different types of partnerships.
- Analyze the advantages of partnerships.
- Analyze the disadvantages of partnerships.

The Main Idea:

Partnerships let individuals pool their resources and share responsibility for the forming and running of a business.

A *partnership* is a business organization owned by two or more persons who agree on a specific division of responsibilities and profits.

- Partnerships account for about 7% of all businesses in the United States.
- Partnerships generate about 5% of all sales and about 10% of all income in the U.S.

Timed write (4 minutes):
In your lecture notes, write about an experience you had where you worked with a partner to fulfill a school assignment, or participate in some volunteer or work effort. What made this work well? What made it difficult?

Partnerships fall into three categories:
General partnerships, Limited partnerships, and Limited liability partnerships.

*1. **General partnerships*** – partnership in which partners share equally in both responsibility and liability.

- Doctors, lawyers, accountants, other professionals often form partnerships with colleagues.

- Small retail stores, farms, construction companies, and family businesses often form partnerships as well.

*2. **Limited partnerships*** – partnership in which only one partner is required to be a general partner. (*Shark Tank*)

- Only one partner has unlimited personal liability for the firm's actions.
- The remaining partner or partners contribute only money. They do not actively manage the business.
- Limited partners can lose only the amount of their initial investment.
- This partnership may have only one general partner, but many limited partners.

*3. **Limited liability partnership (LLP)*** – partnership in which all partners are limited partners.

- An LLP functions like a general partnership, except that all partners are limited from personal liability in certain situations, such as another partner's mistakes.
- Not all types of businesses are allowed to register as limited liability partnerships – most states allow professionals like attorneys, physicians, dentists, and accountants to register as LLPs.

What are the advantages of partnerships?

1. Ease of Start-Up – partnerships tend to be easy and inexpensive to establish.

- It is recommended that partners develop *articles of partnership* – a legal document that spells out each partner's rights and responsibilities.
- *Uniform Partnership Act (UPA)* – act ordering common ownership interests, profit and loss sharing, and shared management responsibilities in a partnership.

2. Shared Decision Making and Specialization

- In a successful partnership, each partner brings different strengths and skills to the business.

3. Larger Pool of Capital

- Each partner's *assets*, or money and other valuables, improve the firm's ability to borrow funds for operations or expansion.
- Partnership agreements may allow firms to add limited partners to raise funds.
- Partnerships attract and keep talented employees – many graduates seek partnership because of the chance to someday become a partner themselves.

4. Taxation

- Individual partners are subject to taxes, but the business itself does not have to pay taxes.

What are the disadvantages of partnerships?

1. **Unlimited Liability** – Unless the partnership is a limited liability partnership, liability at least one partner has unlimited liability.
    - General partners are bound by each other's actions.
2. **Potential for Conflict** – Partnerships also have the potential for conflict.
    - Partners need to ensure that they agree about work habits, goals, management styles, ethics, and general business philosophies.

In your lecture notes:
1. First, examine the graphs on pages 186 and 191.
2. Then, write 3-5 <u>sentences comparing and contrasting</u> the graphs on pages 186 and 191.

SECTION 3 – CORPORATIONS

OBJECTIVES

- Explain the characteristics of corporations.
- Analyze the advantages of incorporation.
- Analyze the disadvantages of incorporation.
- Compare and contrast corporate combinations.
- Describe the role of multinational corporations.

The Main Idea:

Corporations are complex business organizations that can be combined to form even larger businesses. Some corporate enterprises span the globe.

- Businesses often rely on investment to expand operations.
    - One way for a business to increase investment is to form a corporation.
- *Corporation* – a legal entity owned by individual stockholders.
    - Corporations are the most complex form of business organization.
    - Stockholders own *stock* – a certificate of ownership in a corporation.
        - If you own stock in a corporation, you are technically a part-owner of that corporation.
        - Ex. If McDonald's issues 1,000 shares of stock, you own 1/1,000th of the McDonald's corporation.
    - A corporation has a legal identity separate from that of its owners – it is an "entity" –
    - A corporation is legally considered an individual – pays taxes, may engage in business, make contracts, sue other parties, and get sued by others.
    - Corporations account for 20% of U.S. businesses, yet sell 90% of all products.

Types of corporations:

- *Closely held corporation* – corporation that issues stock to only a few people, often family members.
    - Also known as *privately held corporations*.
- *Publicly held corporation* – corporation that has many shareholders and sells stock on the open market.

These stocks are bought and sold at financial markets called stock exchanges (New York Stock Exchange).

Corporate structure – all corporations have the same basic structure.

- Corporation owners – the stockholders – elect a board of directors

This board makes all of the decisions of the corporation.

The board appoints corporate officers, who run the corporation and oversee production.

Corporate officers hire managers and employees, who work in various departments (finance, sales, etc…)

Advantages of Incorporation:

- There are advantages for the individual owners (stockholders) and to the corporation itself.
    - Limited liability for owners
    - Transferable ownership
    - Ability to attract capital
    - Long life

Advantages for stockholders:

1. **The primary reason for incorporation:** the benefit of limited liability.
    - Investors do not carry responsibility for the corporation's actions.
2. **Shares of stock are transferable** – stockholders can sell their stock to others and get money in return.

Advantages for the corporation:

1. **Potential for more growth than other business forms.**
2. **Corporations can borrow money by selling bonds** – a formal contract to repay borrowed money with interest at fixed intervals.
3. **Corporations can hire the best** - experts, analysts, etc…

Long lives – the company does not end with the death of an owner.

Disadvantages of Incorporating:

1. **Difficulty and Expense of Start-Up**
    - Corporate charters can be expensive and time consuming to establish. A state license, known as a *certificate of incorporation*, must be obtained.
2. **Double Taxation**
    - Corporations must pay taxes on their income. Owners also pay taxes on *dividends* – the portion of the corporate profits paid to them.
3. **Loss of Control**
    - Managers and boards of directors, not owners, manage corporations.
4. **More Regulation**
    - Corporations face more regulations than other kinds of business organizations.
    - Must file quarterly and annual reports to the Securities and Exchange Commission (SEC).

Corporate Combinations:

- *Horizontal mergers* – combine two or more firms competing in the same market with the same good or service.
    - Example: Chrysler Corporation and Daimler-Benz formed DaimlerChrysler in 1998
- *Vertical mergers* – combine two or more firms involved in different stages of producing the same good or service.
- A *conglomerate* is a business combination merging more than three businesses that make unrelated products.

Multinational corporation (MNC)– large corporation that produces and sells its goods and services throughout the world.

Advantages of MNCs:

1. **They benefit consumers –** provide products worldwide.
2. **They also spread new technologies and production methods across the globe.**
3. **Jobs –** help poorer nations gain better living standards for their people.

Disadvantages of MNCs:

1. **Some people feel that MNCs unduly influence culture and politics where they operate.**
2. **Critics of multinationals are concerned about wages and working conditions provided by MNCs in foreign countries.**
3. **Environmental concerns.**

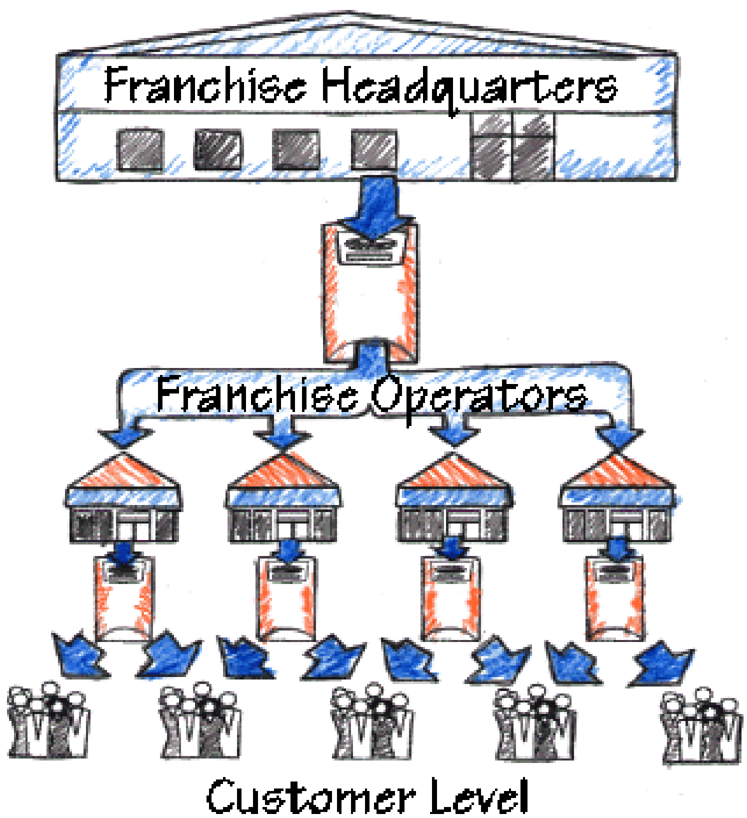
SECTION 4 – BUSINESS FRANCHISES, COOPERATIVES, & OTHER BUSINESS ORGANIZATIONS

OBJECTIVES

- Understand how a business franchise works.
- Identify the different types of cooperative organizations.
- Understand the purpose of nonprofit organizations, including professional and business organizations.

The Main Idea:

Some organizations exist to aid business owners, consumers, producers, industries, workers, or society at large. Many operate without the aim of earning a profit.



Why would a person with dreams of running her own business turn to a multinational company for help?

Business franchise (BF) – a semi-independent business that pays fees to a parent company in return for the exclusive right to sell a certain product or service in a given area.

Franchisers develop products and business systems, then local franchise owners help to produce and sell those products.

Franchises allow owners a degree of control, as well as support from the parent company.

Advantages of Business Franchises:

1. **Management training and support** – for inexperienced owners
2. **Standardized quality** – requirements to follow certain rules or processes to guarantee product quality.
3. **National advertising programs** – parent companies offer far-reaching advertising campaigns to establish their brand.
4. **Financial assistance** – parent companies might offer financing help for franchise owners to help start their business.
5. **Centralized buying power** – buying in bulk helps franchisers save their franchise owners lots of $$$$$

Disadvantages of Business Franchises:

1. **High franchising fees and royalties** – *royalties* are a share of earnings given as payment. Franchisers charge a fee to owners for use of the brand and name.
2. **Strict operating standards** – franchise owners must follow all of the operating rules that are laid out in the franchising agreement – hours of operation, employee dress codes, operating procedures, etc…
3. **Purchasing restrictions** – franchise owners must often buy their supplies from the parent company or from approved suppliers.
4. **Limited product line** – franchise agreements allow stores to offer only approved products.

Why would a customer pay a fee for the privilege of shopping at a certain store?

Cooperative organization (co-op) – a business organization owned and operated by a group of individuals for their mutual benefit.

- *Consumer Cooperatives* – Retail outlets owned and operated by consumers or purchasing cooperatives. Consumer cooperatives sell their goods to their members at reduced prices. (Book Clubs)

- *Service Cooperatives* – Cooperatives that provide a service, rather than goods (MAPS)

Discounted services – insurance, health care, etc…

- *Producer Cooperatives* – are agricultural marketing cooperatives that help members sell their products. (NorPAC)
- *Worker Cooperatives* – worker owned business (BI-Mart)

Why would a customer pay a fee for the privilege of shopping at a certain store?

Nonprofit organizations – function like business but do not operate for profits and are exempt from federal income taxes.

- *Professional Organizations* – work to improve the image, working conditions, and skill levels of people in particular occupations. (The BAR Assoc)
- *Business Associations* – promote the business interests of a city, state, or other geographical area, or of a group of similar businesses. (Chamber of Commerce)

Better Business Bureau – focused on advancing marketplace trust – provides free business reviews on more than 4 million businesses

- *Trade Associations* – Nonprofit organizations that promote the interests of particular industries (Most Industries)
- *Labor Unions* – an organized group of workers whose aim is to improve working conditions, hours, wages, and fringe benefits. (SEA & Plumbers)

Chapter 11 – The Stock Market

OBJECTIVES

- Understand the benefits of buying stock.
- Describe how stocks are traded.
- Identify how stock performance is measured.
- Explain the causes and effects of the Great Crash on 1929.

<u>The Main Idea:</u>

Corporations sell stock to raise money for starting, running, or expanding their businesses. Investors buy stocks to profit through regular payments, called dividends, or by selling the stock at a price higher than the purchase price. Stocks are traded on secondary markets called stock exchanges.

What is a stock? How is it traded? When is it a good investment?

- Corporations can raise money by issuing stock, which represents ownership in the corporation. Stocks are also called *shares* or *equities*.
- Stockowners can earn a profit in two ways:

1. *Dividends*, which are portions of profits, paid out to stockholders. These are paid quarterly (four times a year).
2. A *capital gain* is earned when a stockholder sells stock for more than he or she paid for it. A *capital loss* is when the stock is sold for less than the price for which it was bought.

Types of stock:

Dividend Differences

- *Income stock* pays dividends at regular times during the year.
- *Growth stock* pays few or no dividends. Instead, the issuing company reinvests earnings into its business.

Decision-Making Differences

- Investors who buy *common stock* are voting owners of the company. Typically one vote for each share of stock owned.
- *Preferred stock* owners are nonvoting owners of the company, but receive dividends before the owners of common stock.

Risks of Buying Stock:

- Purchasing stock is risky because the firm selling the stock may encounter economic downturns that force dividends down or reduce the stock's value.
- Stocks are more risky than many other forms of investment – ex. When a firm goes bankrupt.

- A *stockbroke*r is a person who links buyers and sellers of stock.
  - Stockbrokers work for brokerage firms, or businesses that specialize in trading stock.
  - Stockbrokers work with individual investors, advising them to buy or sell particular stocks.
- Some stock is bought and sold on *stock exchanges*, or markets for buying and selling stock.
  - Most newspapers publish data on transactions in major stock exchanges.
  - Major U.S. stock exchanges include the New York Stock Exchange and Nasdaq.

Stock exchanges:

The New York Stock Exchange (NYSE)

- The NYSE is the country's largest stock exchange. Only stocks for the largest and most established companies are traded on the NYSE ("blue chip").

NASDAQ-AMEX

- (the National Association of Securities Dealers Automated Quotations)
- NASDAQ-AMEX is an exchange that specializes in high-tech and energy stock.

The OTC Market

- The OTC market (over-the-counter) is an electronic marketplace for stock that is not listed or traded on an organized exchange.

Daytrading

- Daytraders use computer programs to try and predict minute-by-minute price changes in hopes of earning a profit.

Futures and Options:

- *Futures* are contracts to buy or sell at a specific date in the future at a price specified today.
- *Options* are contracts that give investors the option to buy or sell stock and other financial assets. There are two types of options:

1. Call options give buyers the option to buy shares of stock at a specified time in the future.
2. Put options give buyers the option to sell shares of stock at a specified time in the future.

Bull and Bear Markets:

- When the stock market rises steadily over time, a *bull market* exists.
- When the stock market falls over a period of time, it’s called a *bear market*.

Stock Performance Indexes:

- *The Dow Jones Industrial Average*
  - The Dow is an index that shows how stocks of 30 companies in various industries have changed in value.
- *The S & P 500*
  - (the Standard & Poor’s 500)
  - The S & P 500 is an index that tracks the performance of 500 different stocks.

The collapse of the stock market in 1929 is called the Great Crash.

Causes of the Crash:

- Many ordinary Americans were struggling financially: many purchased new consumer goods by borrowing money.
- Speculation, or the practice of making high-risk investments with borrowed money in hopes of getting a big return, was common.

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BILLIONS LOST AS STOCKS CRASH

Pantages In Jail Awaits Sentence To State Prison

GUILTY SAYS JURY AFTER MANY HOURS

SENATE “FARM BLOC” STARTS BATTLE FOR HIGHER TARIFFS

JURY BELIEVES HER STORY

MAINSTAYS OF MARKET IN PLUNGE

STATE PLANS TO ROUND UP TAX DODGERS

Friend Brings Man To Jail On Rum Charge

BINGHAM TAKES EXCEPTION TO SENATE LOBBY

Alliance Of Two Factions May Win Out

THREE U. S. C. STUDENTS ARE CRASH VICTIMS

CHRISTIANITY MUST DESTROY WAR OR WAR WILL OVERTHROW CHURCH, SAYS PASTOR SCHROCK

Effects of the Great Crash:

- The Crash contributed to a much wider, long-term crisis — the Great Depression during which many people lost their jobs, homes, and farms.
- Americans also became wary of buying stock. As recently as the early 1980s, only about 25 percent of households in the United States owned stock.