Forms of Business Ownership and Organization

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Learning Objectives

1. Discuss why most businesses are small businesses.

2. Determine the contributions of small businesses to the economy.

3. Discuss why small businesses fail.

4. Describe the features of a successful business plan.

5. Identify the available assistance for small businesses.

6. Explain franchising.

7. Outline the forms of private business ownership.

8. Describe the public and collective ownership of business.

9. Discuss organizing a corporation.

10. Explain what happens when businesses join forces.
Most Businesses are Small Businesses

- 99.7% of all U.S. companies are small businesses
- Small businesses generated 64% of new jobs over the last decade
- Small businesses employ almost half of all private sector workers
- Small businesses are a launching pad for entrepreneurs and encourage the prevalence of women and minorities
- Small businesses hire 43% of tech workers and scientists
- Minority Business Development Agency (MBDA)
What is Small Business?

- The **Small Business Administration** defines a small business to be a firm that is independently owned and operated and is not dominant in the field
  - Manufacturing: fewer than 500 workers
  - Wholesalers: fewer than 100 workers
  - Retailers: less than $6 million in annual sales
  - Agricultural business: less than $750,000
- Sizes range from $500,000 to $25 million in sales and from 100 to 1,500 employees
Typical Small-Business Ventures

### Table 5.1: Business Sectors Most Dominated and Least Dominated by Small Firms

<table>
<thead>
<tr>
<th>MOST LIKELY TO BE A SMALL FIRM</th>
<th>FEWER THAN 20 WORKERS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home builders</td>
<td>97%</td>
</tr>
<tr>
<td>Florists</td>
<td>97%</td>
</tr>
<tr>
<td>Hair salons</td>
<td>96%</td>
</tr>
<tr>
<td>Auto repair</td>
<td>96%</td>
</tr>
<tr>
<td>Funeral homes</td>
<td>94%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LEAST LIKELY TO BE A SMALL FIRM</th>
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</thead>
<tbody>
<tr>
<td>Hospitals</td>
<td>14%</td>
</tr>
<tr>
<td>Nursing homes</td>
<td>23%</td>
</tr>
<tr>
<td>Paper mills</td>
<td>33%</td>
</tr>
<tr>
<td>Electric utilities</td>
<td>38%</td>
</tr>
<tr>
<td>Oil pipelines</td>
<td>38%</td>
</tr>
</tbody>
</table>

Major Industries Dominated by Small Businesses

**Figure 5.1**
Industries Dominated by Small Businesses

<table>
<thead>
<tr>
<th>Industry</th>
<th>Percentage of firms with fewer than 500 employees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction</td>
<td>90</td>
</tr>
<tr>
<td>Agricultural Services</td>
<td>88</td>
</tr>
<tr>
<td>Wholesale Trade</td>
<td>66</td>
</tr>
<tr>
<td>Services</td>
<td>56</td>
</tr>
<tr>
<td>Retail Trade</td>
<td>51</td>
</tr>
</tbody>
</table>

Home Based Businesses

- 52% of small businesses operate from an owner’s home
  - 18 million home-based businesses
- Allows for more control of business
- Allows for more control of personal time
- Keeps start-up and operating expenses low (office space can be costly)
- Owner can feel isolated and business has less visibility to customers
Contributions of Small Business

- Create new jobs
- Create new industries
- Encourage innovation (new goods and services)
- Businesses with fewer than 500 employees represent over half of the nation’s GDP
- Account for 13% of all U.S. Exports
- Offer customized services
### Best Industries for Starting a New Business

<table>
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<tr>
<th>INDUSTRY</th>
<th>PREDICTED TREND</th>
</tr>
</thead>
<tbody>
<tr>
<td>Online Marketing</td>
<td>As businesses increase their use of the Internet, including their presence on the web, services to maintain a company’s online impact and image will be in demand.</td>
</tr>
<tr>
<td>App &amp; Game Development</td>
<td>As smart phone use becomes almost universal, apps for services and games continue to grow.</td>
</tr>
<tr>
<td>Online Education</td>
<td>Technological change has allowed for online learning to take place anytime, anywhere.</td>
</tr>
<tr>
<td>Consumer Health Technology</td>
<td>To rein in health care costs, both individuals and corporations are focused on health monitoring and assessment.</td>
</tr>
<tr>
<td>Specialized Online Retail</td>
<td>Consumers continue to love unique and personalized products.</td>
</tr>
<tr>
<td>3D Printing</td>
<td>This technology will revolutionize industries, from automobiles to airplanes, with the ability to bypass parts suppliers and “print” on demand.</td>
</tr>
<tr>
<td>Cloud Services or Virtual Data Rooms</td>
<td>As data continues to grow at lightning speed, so will the demand to access, share, and review documents.</td>
</tr>
<tr>
<td>Building and Maintenance Services</td>
<td>Home maintenance and renovation have grown as the economy recovers.</td>
</tr>
<tr>
<td>Online Travel Agencies</td>
<td>As demand for off-the-beaten-path travel continues, online travel companies will be busy making reservations and creating dream vacations.</td>
</tr>
</tbody>
</table>

**Sources:**  
Small Business Failure

- 7 in 10 businesses will survive at least two years
- 50% of businesses make it to the five-year mark
- By the 10-year mark, 82% of all small businesses have closed permanently

*Data includes companies that have changed their names, changed their legal structure, merged into another firm, or have been sold.

Reasons Why Small Business Fail

- Management Shortcomings is most common
  - Overconfidence, lack of people skills, inadequate knowledge of finance, inventory control, poor time management skills

- Inadequate Financing
  - Overestimating funds generated from initial sales

- Less money to spend on employees, marketing, inventory, and other business costs

- Challenge of meeting government regulation

- Taxes
Sources of Small Business Financing

*Trade credit is purchasing goods or equipment from a supplier who finances the purchase by delaying the date of payment for those goods.

*A line of credit is an agreement between a bank and a borrower, indicating the maximum amount of credit the bank will extend to the borrower.

Note: Total exceeds 100 percent because businesses typically use more than one source of financing.

Businesses need a plan to succeed

A business plan is a written documentation that provides orderly statement of goals, methods, and standards of measurement

Business plans give an organization a sense of purpose

Identifies the company’s mission, goals, and vision

Analyzes unique advantage, customers, and competition
Business Plan Contents

- Executive Summary – who, what, where, why, when, and how questions of the business
- Introduction of content, purpose, objectives
- Financial evaluation of the industry and market conditions, financial forecasts, breakeven, funding
- Marketing – target market and marketing plan
- Resume of principals – important for financing
- Company founders’ mission and vision is addressed
- An outline of what makes the company unique
- Assessment of risks
Small Business Administration

- Government agency assisting small businesses
- Advocate for small business within the federal government
- Financial Assistance
  - Loan Guarantees through banks
  - Microloans of up to $35,000
- Small Business Investment Companies
  - SBICs are run by venture capitalists
- The SBA helps connect small businesses with government agencies to secure work
Other Specialized Assistance

☐ Set-Aside Programs

- 23% of Government Contracts for small business
  - 5% for women and minorities
- Assistance in Financing Government Procurement – Central Contractor Registration

☐ Local Assistance - Business Incubators

- Local community initiatives to share resources for small start-ups
  - SCORE Counselors to America’s Small Business
  - Small Business Development Centers (SBDC)
Private Investors

- Small-business owners soon look for greater sums of money in order to continue operating and eventually grow.
- Venture capital is money invested in the small business by another business firm or group of individuals in exchange for an ownership share.
  - Venture capitalists look for companies in which to invest.
  - Focus is on technology trends:
    - Cloud computing, mobile computing, cybersecurity, and life science investments.
  - Venture capitalists usually have strict requirements for a solid business plan.
  - Venture capital firms are concentrated in Silicon Valley (CA), NY, Boston, Washington, D.C., Seattle, and Texas.
Opportunities for Women & Minorities

- Number of women and minority-owned businesses has far outpaced the national average
- More than 40% of U.S. businesses are owned by women (8.6 million firms)
- Women and minorities still face challenges
  - Smaller scale operations
  - Challenges finding investors
  - Access to capital
- Federal contracting opportunities for WOSB’s (women owned small businesses) have been expanded
Minority-Owned Businesses

![Diagram showing types of businesses owned by racial and ethnic minorities](image)

The Franchising Alternative

- Using another company’s established business model
- A contractual agreement between a manufacturer or another supplier and a dealer to produce and market the supplier’s good or service
- Fastest growth: business, commercial, residential services and quick service restaurants
- Example: McDonald’s, 7-11, Subway
- Entrepreneur Franchise 500
Franchising agreements exist between franchisee (purchaser of the franchise) and franchisor (firm whose products/services are sold by the franchisee).

- Involve initial startup fee plus royalties
- 50% of all retail sales
- 760,000 businesses
- 18 million jobs
- $500 million in payroll
- Near $2 trillion in sales
- New franchise opens every 8 minutes
- Franchising overseas continues to grow
Benefits and Problems of Franchising

ADVANTAGES

- Prior performance record
- Recognizable company name (brand)
- Proven business model
- Tested program management
- Savings through volume purchases

DISADVANTAGES

- Franchise fees
- Future royalty payments
- Linked to reputation and management
- Franchise agreement restrictions
- Tight control
Every business is organized according to one of three categories of legal structure:

- Sole Proprietorship (72%)
- Partnership (9%)
- Corporation (19%)
- Benefit Corporation
- Others: Employee-owned corporations, Family-owned businesses, Not-for-profit organizations
## Comparison of Forms of Ownership

<table>
<thead>
<tr>
<th>Form of Ownership</th>
<th>Number of Owners</th>
<th>Liability</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
</table>
| Sole proprietorship | One owner        | Unlimited personal liability for business debt | 1. Owner retains all profits  
2. Easy to form and dissolve  
3. Owner has flexibility | 1. Unlimited financial liability  
2. Financing limitations  
3. Management deficiencies  
4. Lack of continuity |
| Partnership       | Two or more owners | Personal assets of any operating partner at risk from business creditors | 1. Easy to form  
2. Can benefit from complementary management skills  
3. Expanded financial capacity | 1. Unlimited financial liability  
2. Interpersonal conflicts  
3. Lack of continuity  
4. Difficult to dissolve |
| Corporation       | Unlimited number of shareholders; up to 100 shareholders for S corporations | Limited | 1. Limited financial liability  
2. Specialized management skills  
3. Expanded financial capacity  
4. Economies of large-scale operations | 1. Difficult and costly to form and dissolve  
2. Tax disadvantages  
3. Legal restrictions |
Public and Collective Ownership

- Public (Government) Ownership – a unit or agency of government owns and operates an organization. Parking structures, water systems, turnpike authority.

- Collective (Cooperative) Ownership – collective ownership of a production, storage, transportation or marketing organization is a cooperative
Types of Corporations

- Domestic, foreign, alien
- S Corporation
- Limited Liability Companies
- Employee-Owned Corporations
- Not-for-Profit Corporations
Corporate Management

- Stockholders acquire stocks in exchange for ownership
  - Preferred Stock
  - Common Stock
- Board of Directors elected by stockholders to oversee corporation
- Corporate Officers & Management
  - Make major corporate decisions and handle ongoing operations
Mergers and Acquisitions (M&A)

Merger – combination of two or more firms to form one company
- Vertical – manufacturer and large retailer
- Horizontal – firms in the same industry
- Conglomerate – combines unrelated firms

Acquisition – procedure in which one firm purchases the other and assumes the obligations of another

Joint Venture – partnership between companies for a specific purpose