Chapter 9

Entrepreneurs and Business Organizations

How do entrepreneurs use their resources to start businesses?

9.1 Introduction

In the early 1970s, WLAC-TV in Nashville was looking for a new coanchor for a television news program. They hired a local talent, an articulate young college student and former Miss Black Tennessee. No Nashville television station had ever featured an African American woman as news anchor before, and certainly no 19-year-old had ever coanchored the news, but the station decided to take a chance. In 1973, a young Oprah Winfrey made her television debut on Channel 5 news in Nashville.

Winfrey was not a great success at reading the news, but she stuck with it, determined to have a career in television. Four years later, she moved to WJZ in Baltimore to coanchor the news there. Again she struggled. She tended to get emotional and to stray from the script. Once she even cried on the air.

Winfrey was eventually taken off the news desk and given a morning chat show, *People Are Talking*, to cohost. After the first show, she told herself, "I've found what I was meant to do." Winfrey's relaxed, friendly on-air manner was a hit with viewers, and *People Are Talking* became the most popular talk show in the Baltimore market.

The rest, as they say, is history. In 1984, Oprah moved to Chicago and within two years was hosting the most-watched daytime talk show in the country.

Entrepreneurs, and the businesses they start, play an essential role in the economy.

Speaking of Economics

sole proprietorship
A business owned and managed by one person.

liability
The legal responsibility to repay debts and to pay for damages resulting from a lawsuit.

partnership
A business owned by two or more co-owners who share profits from the business and are legally responsible for the business's debts.

corporation
A business owned by shareholders who have limited liability for the firm's debts. Because it is considered a legal entity, a corporation can conduct business affairs in its name.

multinational corporation
A corporation that does business in more than one country.

business franchise
An arrangement in which a parent company, or franchiser, distributes its products or services through independently owned outlets. The outlet owners, or franchisees, pay for the exclusive right to use the parent company's trade name and sell its products or provide its services.

cooperative
A business organization that is jointly owned and operated by a group of individuals for their mutual benefit.

nonprofit organization
An organization that functions much like a business but does not operate to make a profit.

She also landed a role in the movie *The Color Purple,* for which she was nominated for an Oscar. By the late 1980s, Winfrey became one of the highest-paid performers in the entertainment industry.

If Winfrey had stopped there, she still would have been an outstanding success story. But she did not stop there. In 1988, Winfrey founded her own company, Harpo Productions, becoming the first African American woman to own a television studio. Her corporation has since grown to include magazine publishing and online media.

Oprah Winfrey is not a typical entrepreneur. By the time she started her own business, she was already at the top of her industry. Her wealth and influence made it more likely that her company would succeed. By contrast, many entrepreneurs start from scratch, often borrowing money to start a business.

Winfrey does possess the enormous drive that entrepreneurship requires. It enabled her to overcome poverty and a troubled childhood to become a success in business. As Winfrey put it,

> *Don't complain about what you don't have. Use what you've got . . . Every single one of us has the power for greatness, because greatness is determined by service—to yourself and others.*
>
> —Oprah Winfrey, *Reader's Digest,* February 1989

Winfrey is one of millions of entrepreneurs driven by their dreams and talents to start their own businesses. In this chapter, you will read more about the vital role of entrepreneurs in business. You will explore the advantages and disadvantages of different types of business organizations, and you will look at the rights and responsibilities of owning a business, no matter what its size and structure.

9.2 What Does It Take to Start a New Business?

Unlike Oprah Winfrey, Linda Alvarado faced considerable obstacles when she tried to start her own business. At 24, Alvarado had nearly everything she needed to start her own construction company. She had skills, education, experience—but no money. Because she was a woman, no bank would lend her the money to start a business in an industry dominated by men.

Alvarado's parents mortgaged their home so they could lend her $2,500. In 1976, Alvarado founded Alvarado Construction. Her firm became one of the most successful construction firms in the country. How did she do it? "Perseverance and persistence have kept me going," Alvarado says. Those qualities, among others, are what it takes to start a business.

The Essential Role of Entrepreneurs in Business Creation

An entrepreneur is someone who takes on the responsibility and the risk of starting a business with the expectation of making a profit. Entrepreneurs come from every field of endeavor. The most successful are innovators and creative thinkers. They play a critical role in the economy. By creating businesses, they meet consumer demand for goods and services, create jobs, and spur economic growth.

Thomas Edison, for example, was not only a prolific inventor but also a brilliant entrepreneur. His genius lay in his ability to turn laboratory discoveries into practical inventions that people could use.

Consider the use of electricity to light homes and businesses. Edison did not invent the first incandescent lightbulb, but he did invent the first long-lasting lightbulb that could be used indoors. He also designed the first central power station and, with it, a distribution system for bringing electricity into homes and offices. Edison thus created an entire industry out of a single invention.

Mary Kay Ash, founder of Mary Kay Cosmetics, was a different kind of innovator. Ash wanted to tap into the entrepreneurial energy of women. In 1963, frustrated at the unequal treatment she received as a woman working in sales, Ash started her own company with a $5,000 investment. She bought the rights to special skin-care lotions and creams and hired women to teach customers about the products, rather than pressuring customers to buy. Ash believed in "praising people to success" and rewarded her top saleswomen with pink Cadillacs. Her approach to business was unusual—and successful. At the time of Ash's death in 2001, Mary Kay Cosmetics had made more than $1 billion in sales.

Bill Gates, cofounder of Microsoft, was one of the first to see the enormous potential of the personal computer. In 1975, when Gates was 19 years old, he and his friend Paul Allen formed Microsoft and began developing software. Gates was certain that someday computers would be used in every home and office —and he wanted to be the one to put them there. For Gates's visionary leadership in the information technology revolution, *Time* magazine named him one of the 100 most influential people of the 20th century.

The Characteristics of Successful Entrepreneurs

What do Linda Alvarado, Bill Gates, and Mary Kay Ash have in common? They share certain traits that helped them to succeed. Although there is no single personality profile of the successful entrepreneur, most of them possess the characteristics that follow.

Ambition. Successful entrepreneurs are highly motivated people with the ability to see the big picture and to stay focused on the end result. They set goals for themselves and never stop striving to achieve those goals.

Gallery of Entrepreneurs

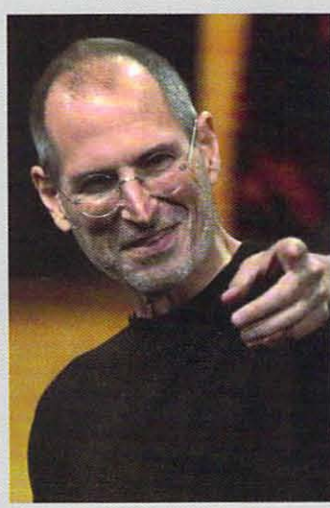
Entrepreneurs are innovators who create new businesses and even new industries. As this gallery suggests, they are often motivated by more than a simple desire to make money.

Andrew Carnegie (1835–1919) was an industrialist, philanthropist, and founder of Carnegie Steel. One of the wealthiest men in the world, Carnegie was as dedicated to giving money away as he was to making it. "The man who dies thus rich dies disgraced," he said. His legacy includes the establishment of public libraries, schools, and universities, as well as funding for the arts.

The Granger Collection, New York

Madam C. J. Walker (1867–1919), the daughter of former slaves, became a businesswoman, philanthropist, and the first woman millionaire. Persistence and hard work were keys to her success. "I had to make my own living and my own opportunity!" she said. "Don't sit down and wait for the opportunities to come. Get up and make them!"

Vera Wang (1949–) is an award-winning fashion designer. Since 1990, when her wedding gown salon opened in New York, she has expanded her business to include fragrances, jewelry, shoes, and housewares. "Don't be afraid to take time to learn," Wang says. "It's good to work for other people. I worked for others for 20 years. They paid me to learn."



Steve Jobs (1955–2011) cofounded Apple Computer in 1976 and later went on to cofound Pixar Animation Studios. Known as a stubborn individualist, Jobs left Apple in 1985 after clashing with the company's management. But he returned to the company in 1997. "I'm convinced that the only thing that kept me going was that I loved what I did," he says. "You've got to find what you love."

Self-confidence. Successful entrepreneurs believe in themselves. They feel certain that they can accomplish what they set out to do.

A willingness to take risks. Entrepreneurs are not afraid to risk their time, money, and energy on a new business idea. "The important thing is not being afraid to take a chance," says Debbi Fields, the founder of Mrs. Fields Cookies. "Remember, the greatest failure is to not try. Once you find something you love to do, be the best at doing it."

Energy and self-discipline. Entrepreneurs thrive on hard work. "The first requisite for success," said Edison, "is to develop the ability to focus and apply your mental and physical energies to the problem at hand—without growing weary."

Perseverance. Entrepreneurs do not give up. "When you reach an obstacle," advised Mary Kay Ash, "turn it into an opportunity. You have the choice. You can overcome and be a winner, or you can allow it to overcome you and be a loser."

Problem solving ability. The ability to come up with solutions to problems marks all successful entrepreneurs. As Linda Alvarado put it, "I believe I will outwork most people in finding a solution."

Organizational skill. Most entrepreneurs own and operate their own businesses. Thus the ability to manage time, resources, and people effectively and efficiently is critical to their success. "Good management," said John D. Rockefeller, founder of Standard Oil Company, "consists in showing average people how to do the work of superior people."

Ability to motivate others. Entrepreneurs are good at inspiring others to join their team. "As we look ahead into the next century," says Bill Gates, "leaders will be those who empower others."

The Risks and Rewards of Starting a Business

Not everyone who sets out to be a business entrepreneur ends up a success. As Figure 9.2 shows, only 46 percent of new businesses survive after five years of being in business. That means 54 percent of new start-ups—more than half—fail. "Once you've hit five years, your odds of survival go way up," observes economist David Birch. "Only two to three percent of businesses older than five shut down each year."

The risk of failure is not the only challenge facing those who hope to become entrepreneurs. Raising money to finance a new business can be difficult, and new business owners are often beset by financial insecurity. Finding the right employees can also be a challenge. In addition, people who run their own businesses typically work long hours, often with little or no pay.

Madam C. J. Walker, an African American founder of a hair-care product company and the first woman to become a millionaire, put it this way: "There is no royal, flower-strewn path to success . . .

Figure 9.2

Analyzing the Survival of Business Start-Ups

Starting a new business is risky. As the graph shows, business start-ups have a high mortality rate. Of the new businesses started in 2005, fewer than half were still operating five years later. By 2012, the survival rate had dropped to 40 percent.

Source: Bureau of Labor Statistics.

If I have accomplished anything in life, it is because I have been willing to work hard."

With all the drawbacks to starting a business, why would anyone want to be an entrepreneur? The answer lies in the incentives-matter principle. Running a successful business of one's own can bring great rewards. The most obvious reward is the nearly unlimited potential to make money. Look no further than Oprah Winfrey and Bill Gates for proof of that. Yet money is not what motivates most entrepreneurs. They simply love what they do. Says Winfrey, "I would do what I'm doing even if I weren't getting paid."

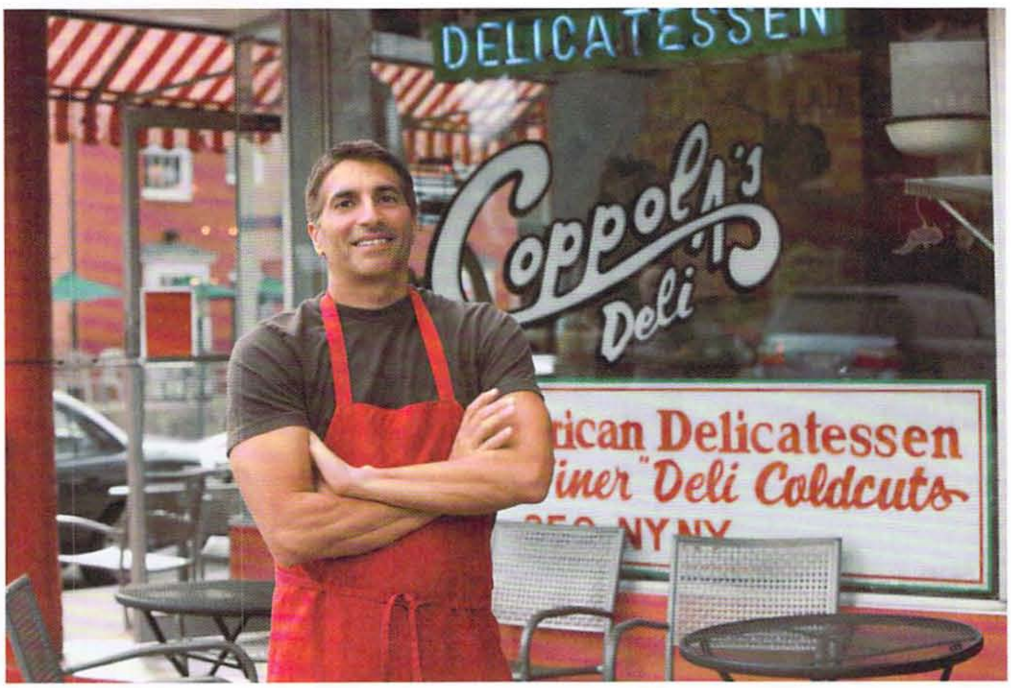
Part of the personal satisfaction of entrepreneurship comes from the freedom it affords. As a business owner, you are your own boss. You set your own hours, and you do what makes you happy. Entrepreneur Stephen Fairchild, for example, was always an avid spelunker, or cave explorer. In 1972, he sold everything he owned and quit his job to take over a company operating tours of Boyden Cavern, a cave in Giant Sequoia National Monument. He is now head of a company that owns other show caves and operates tours of a gold mine. "Being a 'cave entrepreneur' is the perfect marriage of hobby and career," Fairchild says. "I take extreme pride in what I do, but more important, I thoroughly enjoy what I do!"

Many entrepreneurs also take satisfaction in knowing that they are contributing to the economy. New businesses can breathe economic life into depressed areas, creating new jobs and helping to support existing businesses. Successful business owners often become community leaders who invest in community projects and give to local charities.

For Jerry Greenfield, cofounder of Ben & Jerry's, a successful ice cream company, the chance to make positive change through business leadership was exciting. "We measured our success not just by how much money we made, but by how much we contributed to the community," says Greenfield. "It was a two-part bottom line."

9.3 What Kinds of Businesses Are Best Organized as Sole Proprietorships?

Businesses come in all shapes and sizes, ranging from small home-based businesses to huge companies with offices around the world. Economists categorize businesses based on how they are organized. Most U.S. business organizations fall into one of three general categories: sole proprietorships, partnerships, or corporations. The most common is the **sole proprietorship**, a business owned and managed by one person.



Sole proprietorships are businesses owned and operated by one person. Many small, service-oriented businesses, like this deli owner, are organized in this way.

Sole Proprietorships: One Owner, One Operator

In a sole proprietorship, the owner of the business —the proprietor—earns all the profits and is responsible for all the debts. This form of business can be simple to establish and easy to manage, with relatively low start-up costs.

This is the kind of business Timothy Redel chose when he started his photography business. Redel had traveled all over the world working as an assistant for other photographers before he went into business as a sole proprietor. To do so, he borrowed $10,000 from a bank. With these funds, he bought cameras and lighting equipment and set up shop, using his small apartment as a studio. He went on to become a highly successful photographer whose work has appeared in many national magazines.

The ease of starting a sole proprietorship is probably why about 7 out of 10 businesses are organized this way. It is a form of business that appeals to people who have a marketable skill or trade and want to work for themselves rather than a boss. A sole proprietor might be a plumber, a pet sitter, a caterer, a farmer, a consultant, or an artist like Redel.

Advantages of Sole Proprietorships

For anyone thinking of starting a business, the sole proprietorship offers a number of advantages.

Ease of start-up. There is little paperwork involved in starting a sole proprietorship. Though requirements vary by city and state, the basics include

- obtaining a **business license** or **business permit,** a legal document that allows a business to operate in that state, city, or town.
- obtaining any necessary **zoning permits**. Local governments often designate certain areas, or zones, for specific business purposes.
- registering the **business name.** If a business carries the owner's legal name—as in Timothy Redel Photography—this step is not necessary. If not, the proprietor must submit a "doing business as" form to the local government office.

Few restrictions. Sole proprietorships are the least regulated form of business. However, some regulations do apply to specific industries. For example, any business that serves food is subject to health department regulations.

Full decision-making power. A sole proprietor makes all business decisions without having to consult with partners or shareholders. The freedom to make decisions quickly in response to market changes can be a great advantage for a business owner.

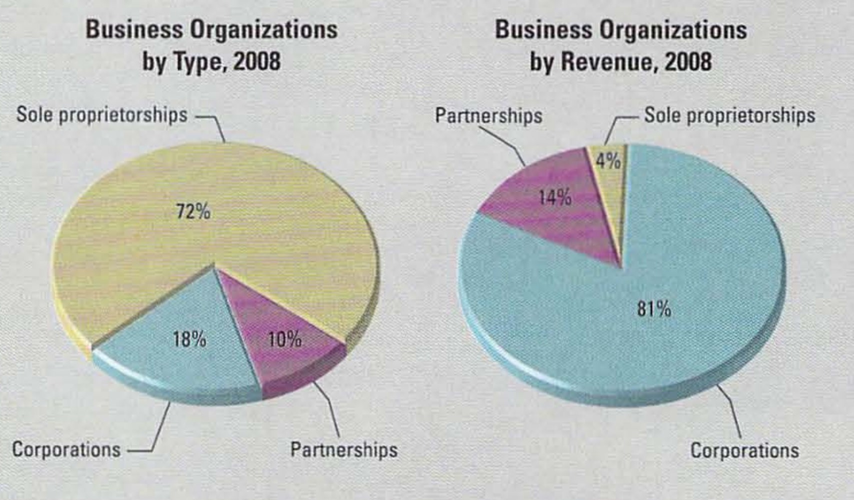
Full profits and individual taxation. A sole proprietor keeps all the profits generated by the business after paying taxes. Sole proprietors pay personal income tax on their earnings. The business itself pays no taxes.

Ease of closing. Sole proprietors can dissolve their businesses easily if they choose to do so. However, they must pay off business debts and taxes.

Figure 9.3

Analyzing U.S. Businesses by Form and Revenue

Sole proprietorships are by far the most common form of business in the United States. But because sole proprietorships are typically small businesses, they generate far less revenue than do large corporations.



Source: U.S. Internal Revenue Service.

Key Concept

Sole Proprietorship

A sole proprietorship is a business owned and operated by one person. The owner keeps the profits, if any, and is liable for debts.

- Advantages include ease of opening, few regulations, and decision-making control by the owner.
- Disadvantages include modest growth potential and a limited business life.

Disadvantages of Sole Proprietorships

Sole proprietorships also have disadvantages. Below are the three main drawbacks of this form of business.

Unlimited liability. The legal obligation to pay debts is known as **liability**. Sole proprietors have **unlimited liability,** or full responsibility for paying any debts their businesses take on. If a business does not have enough assets to repay its debts, the owner must use his or her personal assets—such as a home, car, or bank account—to do so. Unlimited liability is the tradeoff a sole proprietor makes for having complete control and reaping all the profits.

Many sole proprietors reduce their liability by organizing their business as a **limited liability company**. As in a sole proprietorship, the proprietor of an LLC pays personal income tax on the business's profits. But the proprietor's liability is limited to whatever he or she has invested in the company. This feature of LLCs has made them increasingly popular with business owners in recent years.

Limited growth potential. Because the success of a sole proprietorship rests on just one person—often a novice entrepreneur with limited assets—investors may be reluctant to lend money to a sole proprietor. Sole proprietorships can thus have difficulty obtaining the capital needed to expand. Business growth often depends on profits that can be reinvested in the enterprise.

Limited life. A sole proprietorship almost always ceases to operate if the owner dies, goes bankrupt, or is unable to run the business for any reason. New management does not usually take over this type of business. This lack of permanence may discourage some people from seeking work in a sole proprietorship. It may also make lenders reluctant to make loans to businesses with a single owner.

9.4 What Kinds of Businesses Are Organized as Partnerships?

In 1988, brothers Wing Lam Lee, Ed Lee, and Mingo Lee decided to go into the restaurant business together. The brothers were surfers who had grown up in Brazil, had surfed in Mexico, and had worked in their family's Chinese restaurant. All of these influences came together in their first restaurant: Wahoo's Fish Taco in Costa Mesa, California. Wahoo's featured a Mexican-Brazilian-Asian menu with grilled fish tacos as the specialty. The restaurant was so successful that by 2013, the partners had opened more than 60 Wahoo's.

Partnerships like that of the Lee brothers are well known in the business world. Ben Cohen and Jerry Greenfield, friends since middle school, founded Ben & Jerry's. Google, the Internet search company, was founded by partners Larry Page and Sergey Brin. Partnerships are the second most common form of business organization in the United States.

Partnerships: Multiple Owners, Shared Profits

A **partnership** is a business owned by two or more co-owners. Partners share profits from the business. They also share liability for any debts the business incurs. Family-owned businesses, small stores, farms, and medical practices are common examples of business partnerships. Law firms, accounting firms, and money-management firms also frequently form partnership agreements.

Partnerships may be formed by an oral agreement. However, the more common practice is to draw up a legally binding written agreement. There are different kinds of partnerships, each of which confers different

This mother and daughter duo have opened their own garden supply shop.

responsibilities on the partners. The following are the three most common kinds of business partnerships:

General partnership. A **general partnership** is a form of business in which all co-owners have unlimited liability for any business debts. The owners, or **general partners,** are also active in the operations of the business.

Limited partnership. A **limited partnership** has at least one general partner and one or more limited partners. The **limited partners** contribute financial capital but leave day-to-day business operations to the general partners. For this reason, limited partners are also known as **silent partners.**

The main advantage of being a limited partner is **limited liability** for debts owed by the partnership. Limited partners can lose only the amount of money they invested in the business should it be sued or go bankrupt.

Limited liability partnership. In a **limited liability partnership,** co-owners are allowed to operate like general partners while enjoying the protection of limited liability. An LLP is well suited to businesses in which all partners want to take an active role in managing the business. Professionals, such as attorneys, doctors, dentists, and accountants, often form LLPs.

Advantages of Partnerships

Like sole proprietorships, partnerships offer entrepreneurs a number of advantages.

Ease of start-up. Partnerships are relatively easy to establish. The same business permits that are required for a sole proprietorship are also required for a partnership. In addition, business and legal experts recommend that a legal agreement, known as **articles of partnership,** be drawn up. Articles of partnership usually specify

- each partner's contribution in assets and labor.
- each partner's share of the profits and losses.
- each partner's authority and duties.
- how partners will settle disagreements.
- what happens in the event that a partner dies or leaves.
- how assets will be divided if the business fails.

If articles of partnership are not drawn up, most states have guidelines regarding partner rights and responsibilities that automatically go into effect.

Few restrictions. Partnerships are subject to few government regulations. However, like sole proprietorships, they must meet industry-specific regulations, such as health codes.

"It seems pretty easy to make partner here."

"Making partner" is the goal of most professionals who join a limited liability partnership. But becoming a partner is seldom as easy as this cartoon implies.

Shared decision-making power. "Two heads are better than one" is the philosophy guiding most partnerships. Partners can pool their experience and skills in making the decisions that guide the business.

Specialization. Partners often bring different areas of expertise to a business. For instance, one partner may be good at managing people, whereas another may be a marketing whiz. Partnerships allow partners to do what each does best for the company's overall benefit.

Individual taxation. Partners share in the profits according to whatever arrangement they have made. Each partner pays income taxes on his or her share. The business itself does not have to pay taxes.

Increased growth potential. People who go into business together each bring financial assets to the enterprise—their own assets as well as those of family and friends. Banks therefore see less risk in lending money to a partnership than to a sole proprietorship, which draws on the assets of just one person. For the same reason, suppliers are more willing to extend credit to a partnership.

With greater access to capital, partnerships often find it easier to expand their operations than do sole proprietorships. They are also better able to attract and hire talented employees, some of whom may aspire to become partners themselves some day.

Disadvantages of Partnerships

Partnerships also have drawbacks.

Unlimited liability for general partners. Unless a partnership is a LLP, at least one partner—the general partner—has unlimited liability for debts. Should the business run into financial problems, general partners stand to lose not only what they have invested but also their personal assets outside the business.

Conflict between partners. Like any relationship, a business partnership has the potential for conflict. Partners who see eye to eye when they first go into business may come to disagree about management style, work habits, ethics, or the firm's general goals and direction. Partnership agreements do not address such issues. Good communication and an honest effort to resolve conflicts are essential if a partnership is to survive.

Key Concept

Partnership

In a partnership, two or more owners own and operate a business together. The partners share the profits, if any, and the liability for debts.

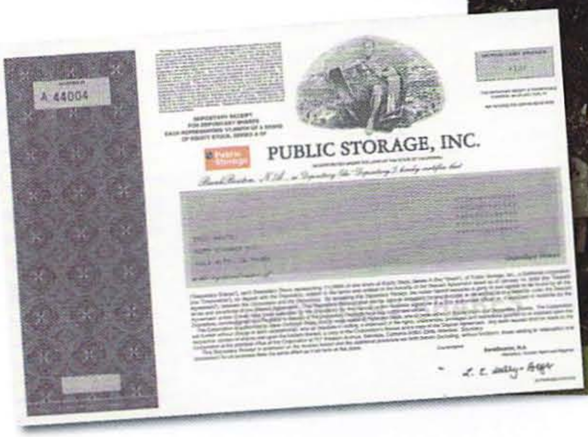
- include ease of start-up, shared decision making, and the chance to specialize.
- Disadvantages include the potential for conflict among partners and continuity issues

Continuity issues. Partnerships are a temporary form of business. If one partner dies or decides to leave a partnership, the remaining partners will need to buy out the former partner's share. The value of this share may be difficult or impossible to determine. Moreover, the remaining partners may not have the liquid assets needed to buy it. Survival may depend on finding a new partner with the financial resources to purchase the outgoing partner's share of the business.

9.5 Why Are Large Businesses Organized as Corporations?

Sometimes sole proprietors or partners realize that they need more financial capital to grow their businesses than they can provide on their own. One way to raise these funds is to seek venture capital. **Venture capital** is money from an individual investor or organization that invests in promising new businesses in exchange for a share of ownership. Another common way to raise money is to sell shares in the company to the public on the stock market. In either case, this is the time for the company to be reorganized as a corporation.

A stock certificate is a legal document that shows the number of shares of stock a shareholder owns in a corporation. This certificate indicates ownership of shares in Public Storage, the world's largest operator of self-storage facilities.



Corporations: Ownership by Shareholders

The word *corporation* has its roots in the Latin word *corpus,* which means "body." The root of the word reflects the modern legal definition of **corporation:** a company treated under the law as a single body with its own powers, separate from its owners. A corporation can enter into a contract. It can buy and sell property, just as an individual can.

Corporations are owned by shareholders who purchase shares of company stock. When a business becomes a corporation, it may offer for sale anywhere from several thousand to several million shares of stock. Such a stock offering might bring the company millions or even billions of dollars in new financial capital. It is easy to see why companies looking to expand might choose incorporation.

Ben & Jerry's offers a good example. Begun in 1978 as a partnership, the ice cream company became a corporation in 1984. That year, it offered stock to Vermont residents only, raising $750,000 for a new manufacturing facility. The following year, Ben & Jerry's stock was offered for sale to the general public. Using the revenue from stock sales, the company expanded its operations, distributing its ice cream outside of New England for the first time.

There are two kinds of business corporations. A **privately held corporation** is owned by an individual or a small group of individuals. It allows only a select group of people, often members of a family, to purchase stock. The stock is usually not for sale to the general public. A privately held corporation is also known as a **closely held corporation**.

If a privately held corporation grows significantly, it may take steps to become, or may be sold to, a publicly held corporation. A **publicly held corporation** offers stock for sale to the general public and has many shareholders. This is the type of corporation Ben & Jerry's became when it sold stock to the public. Stock in publicly held corporations is typically bought and sold through a stock exchange.

How Corporations Are Organized

Corporations all tend to be organized in much the same way. As shown in Figure 9.5A, the typical corporation is a hierarchy with different levels of employees. Every employee in a corporation reports to a higher-level employee. That person reports to an even higher-level employee, and so on. At the top of the corporate hierarchy sits the board of directors, which reports to the shareholders.

A **board of directors** is a governing body that is elected by the shareholders. The board oversees management of the corporation. It also establishes corporate policy and makes sure the company's resources are being managed effectively.

In many corporations, the board of directors is made up of "inside" as well as "outside" directors. An **inside director** is someone from within the firm, such as the company's founder or a senior-level manager. An **outside director** is someone from outside the firm who can provide an independent perspective.

One of the board's most important responsibilities is to select the corporation's **chief executive officer**. The CEO is the highest-ranking person in charge of managing a corporation.

The CEO usually appoints other **corporate officers**—senior executives who oversee specific areas of the business. For example, the chief financial officer (CFO) is in charge of a company's finances. The chief operating officer (COO) manages the day-to-day operations of a company. Other departments that are typically headed by corporate officers include marketing, legal, and information technology.

These corporate officers, along with other senior executives, make up the senior management of a corporation. Reporting to them is a broad swath of managers known as **middle management**. This next level includes vice presidents, department heads, and managers of various ranks. Middle management is responsible for supervising the day-to-day activities of the firm's workers.

Advantages of a Corporation

Businesses organized as corporations offer a number of advantages over sole proprietorships and partnerships.

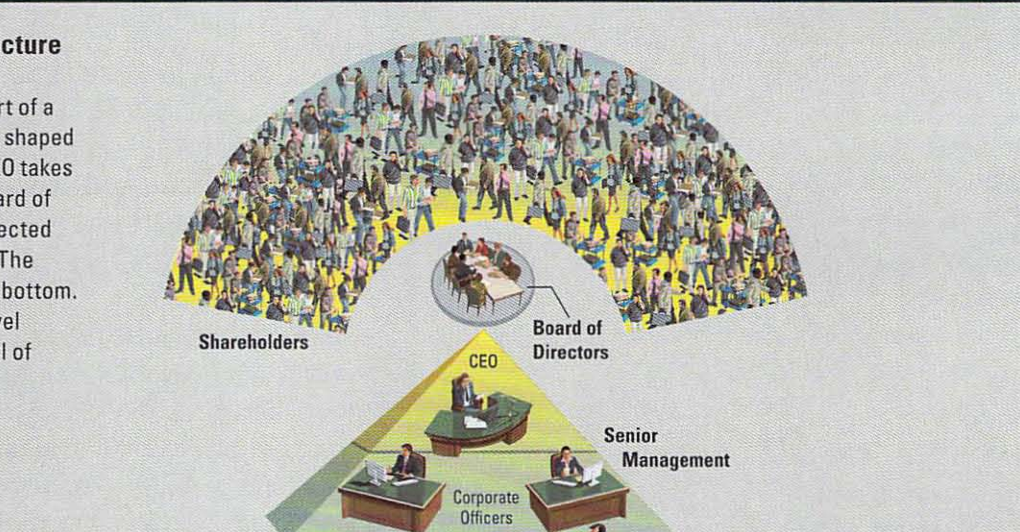
Limited liability. A corporation's owners—the shareholders—are liable only for the amount of money they have invested. For example, suppose an investor buys 100 shares of stock at $30 a share. If the corporation goes bankrupt, the investor will lose that $3,000 investment. His or her personal assets are never at risk. The corporation is liable for its debts, however, because the law considers it a legal entity, like a person.

Growth potential. Because corporations can use the sale of stock to raise financial capital, they have far greater potential for growth than do other forms of business. For example, Google offered stock to the public in 2004 in what is called an

Figure 9.5A

Analyzing the Structure of a Corporation

The organization chart of a typical corporation is shaped like a pyramid. The CEO takes direction from the board of directors, which is elected by the shareholders. The employees are at the bottom. Managers at each level oversee the next level of workers below them.



initial public offering. On the first day of Google's IPO, 22 million shares were sold. This sale raised about $1.2 billion for the company.

Professional management. Whereas sole proprietors and partners must manage their businesses themselves, corporations are run by professional managers. These managers often specialize in a particular area, such as finance or public relations. With this expertise, corporations can increase efficiency to a level that often is not possible in smaller organizations.

Long life. Unlike sole proprietorships and partnerships, corporations continue to exist when founders die or owners sell their shares. As legal entities, corporations have permanence. For example, the company that became IBM Corporation was founded in 1888 and incorporated in 1911. Today it is one of the largest information technology employers in the world. This ability of corporations to continue indefinitely supports growth and long-range planning efforts.

Disadvantages of a Corporation

Although incorporation provides businesses with important advantages, it also has disadvantages.

Complexity of start-up. Businesses that want to incorporate are legally required to follow certain procedures.

Key Concept

Corporation

A corporation is a legal entity owned by shareholders who buy stock in the company. Shareholders share profits, if any, but have only limited liability for debts.

- Advantages include professional management and permanence.
- Disadvantages include the complexity of start-up and the double taxation of profits.

- They must develop a prospectus. This document outlines for potential investors the main features of the enterprise and contains information about the stock being offered.
- They must apply for a business license. All states require new corporations to file a set of documents called **articles of incorporation,** also known as a corporate charter. A **corporate charter** details the company's objectives, structure, and planned operations. It also specifies the number of shares of stock that may be issued. When state officials approve the charter, the company becomes a legal corporation.
- They must create **corporate bylaws,** or rules that govern the management of the corporation. Bylaws deal with such topics as how to conduct shareholder meetings, how to elect directors, what officers the organization will have, and what the duties of those officers will be.
- They must hold a meeting of shareholders to elect a board of directors.
- They must issue stock certificates to shareholders. A **stock certificate** is a legal document that certifies ownership of a specific number of shares in the corporation.

Loss of control. Once a business has been incorporated, the role of the original owner or founder may change. Decisions once made by the founder become the responsibility of the board of directors and the professional management team. For the founder, the change usually means giving up some control of the company.

More government regulation. Corporations are subject to more government regulation than are other types of businesses. For example, corporations are required to hold annual shareholder meetings. They must maintain detailed records of business transactions. Publicly held corporations must also file regular reports with the Securities and Exchange Commission, the federal agency that regulates the stock market.

Double taxation. Corporations face heavier taxes than do sole proprietorships or partnerships. As legal entities, corporations are required to pay taxes on their profits. In addition, shareholders must pay income tax on any dividends they receive. Taxation at the corporate level and again at the shareholder level is known as **double taxation**.

Figure 9.5B

Mapping a Multinational Corporation

In the past, most multinational corporations were based in Western Europe and North America. In recent decades, however, many Asian companies have gone global. The map shows the worldwide reach of LG Electronics, a multinational corporation based in South Korea.

Multinational Corporations: Doing Business on a Global Scale

Business enterprises that operate in more than one country—known as **multinational corporations**—are not new. They have existed since the 1600s, when English and Dutch trading companies first established outposts in the East Indies.

However, in the past few decades, the number of global businesses has skyrocketed. In 1990, there were about 3,000 multinational corporations. By 2009, there were more than 82,000 parent corporations with over 807,000 affiliates around the globe. Contrary to what many people think, not all of them are corporate giants like Coca-Cola and Exxon. Most are smaller firms having fewer than 250 employees.

As Figure 9.5B shows, such corporations typically have headquarters in their "home" country. They then operate production facilities or deliver services in at least one other country. Each branch of a multinational must obey the laws of the country in which it is located, including tax laws.

Multinational corporations have advantages that other firms do not have. Their global reach gives them access to more markets, with greater potential for increased sales and growth. Access to multiple markets also makes it less likely that a multinational will go bankrupt than will a smaller firm operating in a single market. Moreover, multinational corporations often have access to cheaper labor and raw materials than they would find in their home countries. Locations in multiple countries may also reduce their transportation costs. For all these reasons, the number of global corporations is likely to continue to increase.

9.6 What Purposes Are Served by Franchises, Cooperatives, and Nonprofit Organizations?

Not every business enterprise falls neatly into one of the three business models described in this chapter. There are also other types of business organizations that people adopt to achieve specific goals. One model is the business franchise.

Business Franchises: One Parent Company with Many Outlets

In a **business franchise,** a parent company grants to an independent business owner the exclusive right to use its trade name and sell its products in a designated location. This is the kind of arrangement that such companies as Holiday Inn, McDonald's, and Dunkin' Donuts use to distribute their products.

Under a franchise agreement, a parent company, or **franchiser,** grants a license to operate an outlet in return for an initial payment and ongoing fees. The business owner who buys the license and distributes the franchiser's products is the **franchisee**. The franchise model is well suited to businesses whose products or services can easily be replicated, or "cloned." Motel rooms, hamburgers, and donuts are just such products.

Franchise agreements are popular because they offer advantages to both the parent company and the local franchise owner. Franchising enables a parent company to expand rapidly and more cheaply than if it had to own and operate new outlets itself.

At the same time, franchising gives people who want to own a business the opportunity to do so with some support. Franchisers help new owners get started with management training, budgets, and advertising campaigns. Moreover, many franchises have a record of profitability and a built-in customer base. For the would-be business owner, buying a franchise may be less of a financial risk than starting one's own business.

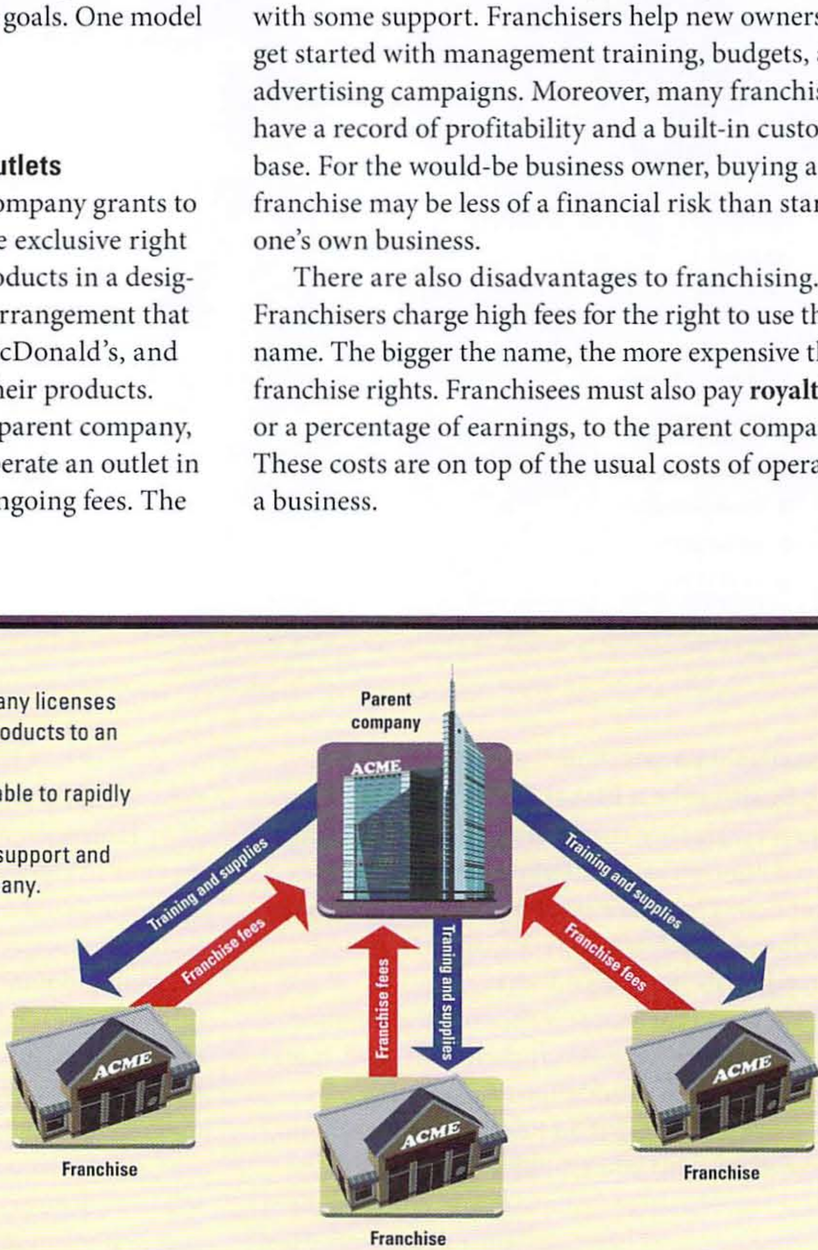
There are also disadvantages to franchising. Franchisers charge high fees for the right to use their name. The bigger the name, the more expensive the franchise rights. Franchisees must also pay **royalties,** or a percentage of earnings, to the parent company. These costs are on top of the usual costs of operating a business.

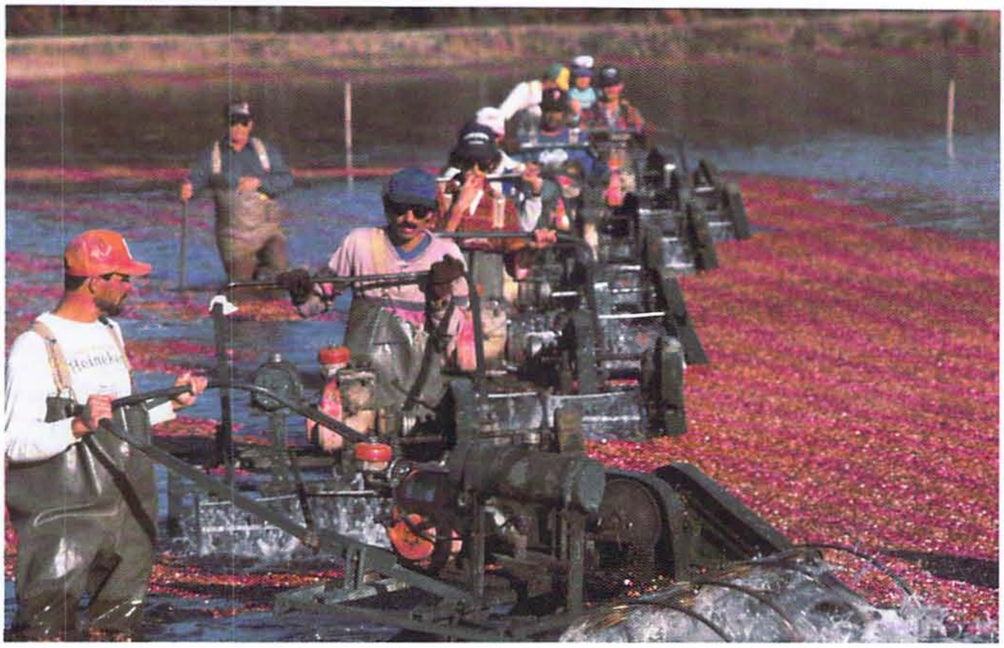
Key Concept

Business Franchise

In a business franchise, a parent company licenses its trade name and the right to sell its products to an independent business owner for a fee.

- The parent company gains by being able to rapidly expand its distribution network.
- The franchise owner gains from the support and training provided by the parent company.





Hundreds of cranberry growers in North America market their crop through the Ocean Spray agricultural cooperative. When founded in 1930, the co-op's main product was cranberry sauce. Today it markets a wide range of juices along with dried cranberries.

In addition, being a franchise owner means giving up some independence. Franchise agreements usually require franchisees to follow strict rules and procedures. For some aspiring entrepreneurs, this lack of independence may be a big drawback.

Cooperatives: Share Ownership for Shared Benefits

Another popular form of business organization is the cooperative, or co-op for short. A **cooperative** is a business that is owned and operated by a group of individuals for their shared benefit. Some 130 million Americans were members of some type of co-op in 2013.

Cooperatives are businesses, but with some important differences. Co-ops are not in business to make a profit. Rather their goal is to meet their members' needs for affordable goods and services. Co-ops are run democratically, with members electing other members to a board of directors.

Many people who join co-ops are consumers looking to increase their buying power. Consumer co-ops sell goods to their members at reduced prices. They can do this because they purchase bulk quantities at a lower cost. The requirements of membership in a consumer co-op vary. Some co-ops require members to work a certain number of hours, whereas others require a yearly membership fee. Food co-ops, housing cooperatives, and discount price clubs are types of consumer cooperatives.

Other kinds of consumer co-ops provide services instead of goods. Such services include health care, childcare, and insurance services. Credit unions, or financial cooperatives, make low-cost loans to their members. Electric cooperatives, found mainly in rural areas, provide low-cost electricity to their members. In 2010, electric co-ops delivered electricity to 42 million Americans.

Producers also form cooperatives. The most common producer cooperative is the agricultural co-op, also known as a farm organization. Some agricultural co-ops function like consumer co-ops, providing farmer members with low-cost seeds and equipment. Other agricultural co-ops help to market and sell members' products. Some well-known food brands, such as Sun-Maid, Land O' Lakes, and Ocean Spray, are agricultural co-ops. Ocean Spray, the producer of juice drinks, is owned by over 600 cranberry and grapefruit growers in the United States and Canada.

Nonprofit Organizations

Yet another common business model is the nonprofit organization. A **nonprofit organization** functions like a business, except that it does not operate to make a profit. Instead, nonprofits are established to support particular public or private goals. Human rights, the arts, the environment, religion, and medical research are just a few of the areas in which nonprofits are active. Nonprofits range from global organizations like the Red Cross to local soup kitchens and animal shelters, as you can see in Figure 9.6.

Although some nonprofit groups are organized informally, many seek nonprofit status from the federal government. Nonprofit organizations may be tax exempt, which means they are not required to pay income tax. However, tax-exempt nonprofits are limited to how much income they can earn and how they may use their earnings. Most groups are funded, at least in part, by donations.

A nonprofit may be organized in a variety of ways: as a corporation, a cooperative, a trust, or a foundation. Conservation nonprofits are often organized as land trusts. For example, the Nature Conservancy is a land trust that works to protect wilderness areas and waterways around the world as nature preserves.

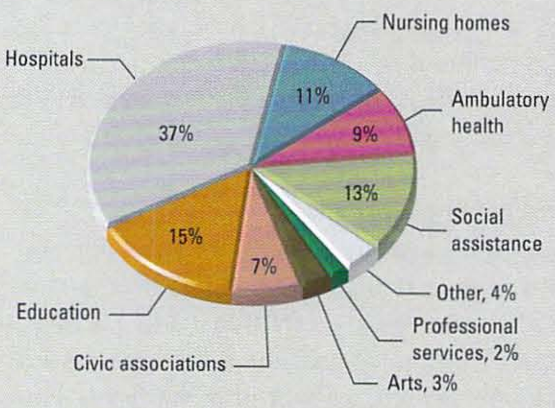
A **foundation** is an organization that is created and supported by donated funds or property. Foundations are often created by people who have made fortunes in business. Bill and Melinda Gates, for example, created a foundation dedicated to "bringing innovations in health and learning to the global community." Since its founding in 1994, the Bill and Melinda Gates Foundation has given billions of dollars to groups working to improve health care and education in developing countries and in the United States.

Figure 9.6

Analyzing Nonprofits

Nonprofit organizations are active in many fields. However, the majority of people employed by nonprofits work for organizations that provide health care services.

Nonprofit Paid Employment by Field, 2010



Source: Lester M. Salamon, S. Wojciech Sokolowski, and Stephanie L. Geller, "Holding the Fort: Nonprofit Employment During a Decade of Turmoil" (Baltimore: Johns Hopkins Center for Civil Society Studies, Jan. 2012). Note: Percentages do not add to 100 due to rounding.

Other kinds of nonprofit organizations support the interests of businesses and professional people. A **business association** represents the interests of businesspeople in a geographical area. Such organizations often go by the title of Chamber of Commerce.

A **trade association** represents the interests of people working in a particular industry. Trade associations include groups like the Alliance of Automobile Manufacturers and the Motion Picture Association of America. Such groups use advertising, education, and political lobbying to promote their interests.

People who work in a profession, such as medicine or teaching, often join a **professional organization**. These nonprofits establish standards of training and ethics for professionals in their fields. They also work to improve conditions for people in their profession. The American Nurses Association, for example, represents over 3 million registered nurses. It promotes the rights of nurses in the workplace and lobbies Congress on health care issues that affect nurses.

Labor unions are organizations of workers in a specific industry. A labor union seeks to improve working conditions, wages, hours, and benefits for its members. Labor unions are active in a wide range of industries. Actors, miners, police officers, and aerospace workers, for example, are all represented by unions.

9.7 What Rights and Responsibilities Do Businesses Have in a Free Enterprise System?

In 2007, Facebook, the social-networking Web site, launched an advertising system called Beacon. Under this system, every time a Facebook user purchased a product from a partner company, such as eBay or Amazon, the user's Facebook friends were automatically notified. Many Facebook members saw this as a violation of privacy. For example, one member bought a diamond ring for his wife, and the surprise was spoiled when his wife and all his friends were informed. Thousands of members signed online petitions protesting the new system.

At first Facebook, which stood to gain huge revenues from advertisers through Beacon, refused to change the system. But when the controversy prompted three big advertisers to threaten to pull out, CEO Mark Zuckerberg did an about-face. He apologized to users and modified the system so that a user could turn off Beacon. Threatened with the loss of revenue, he gave in to his customers' demands.

The Rights of Businesses

Zuckerberg's missteps with Beacon raised an interesting question: What rights do businesses have when it comes to using information about their customers? In a free enterprise system, businesses clearly have many of the same rights that individuals have. These include the right to own property and to enter into and enforce contracts. Following are other specific rights of business.

The right to advertise. The First Amendment's guarantee of freedom of speech did not originally protect the right of businesses to advertise. In recent decades, however, courts have ruled that advertising is "commercial speech." As such, it is protected under the Constitution. With certain exceptions, such as ads for alcohol and tobacco, the government places few restrictions on how companies can market their products.

The right to hire and fire employees. Most states have "employment at will" regulations that protect a business's right to hire or fire employees as its needs change. They also protect an employee's right to quit a job for any reason. The main exception to this rule is when a contract exists between a business and an employee. Unless the contract states otherwise, the employee cannot be fired until the contract ends.

The right to screen employees. Businesses have a legal obligation to provide a safe workplace for their employees and clients. To do so, they have the right to perform background checks on job candidates as well as drug testing on job applicants and employees.

The right to be fairly compensated for property. The Fifth Amendment prohibits the government from taking private property for public use without paying a fair price for it. This right to fair compensation applies to businesses as well as individuals. It ensures that business owners and shareholders will not lose their investment should the government need to take over their property.

Figure 9.7

Identifying Intellectual Property Symbols

Businesses use a variety of symbols to identify and protect their intellectual property. The most important are illustrated here.

TM Used to identify an unregistered trademark that identifies the source of a good.

SM Used to identify an unregistered service mark that identifies the source of a service.

® Indicates that a trademark or service mark has been registered with and is protected by the federal government.

© Used to indicate that a written or visual work is protected under copyright laws.

℗ Used to indicate that a sound recording is protected under copyright law.

Patent Pending Indicates that a patent has been applied for but has not yet been issued.

US Patent 1234567 Indicates that a patent has been issued in the United States.

The right to protect intellectual property. Businesses are free to use patent, copyright, and trademark laws to protect their exclusive rights to intellectual property. A **trademark** is a distinctive name or symbol that identifies a firm and its products or services and that has been legally registered as the property of that firm. Other forms of protected intellectual property include trade secrets, company logos, designs, and inventions—in short, any intellectual product that has commercial value.

The Responsibilities of Businesses

The list of rights does not answer the question raised by Facebook users about Beacon and its use of information related to their shopping habits. Nonetheless, the users who signed protest petitions clearly felt that Zuckerberg had a responsibility to act on their privacy concerns.

Businesses, like individuals, have many responsibilities. Some are based on our expectations about how a business should behave. Others are enshrined in law.

Obtaining licenses and permits. Businesses must obtain all licenses and permits required by law. For example, a business that uses or stores hazardous materials is required to get a fire department permit. People practicing certain trades or professions, such as plumbers, electricians, and doctors, must be licensed. Such regulations are intended to ensure public safety.

Paying taxes. Business owners are responsible for paying all taxes that apply to their businesses. These may include income, sales, and property taxes. Businesses that do not pay their taxes are subject to penalties and fines.

Dealing honestly. Businesses have a responsibility to deal honestly with their customers and suppliers. Businesses that intentionally misrepresent facts, conceal information, publish false or misleading ads, or otherwise try to cheat people are committing fraud. Business fraud is against federal and state law and is subject to prosecution.

Honoring contracts. Businesses, like individuals, may choose whether to enter into a contract. However, once entered into, a contract is legally binding. Businesses thus have an obligation to honor their contracts with customers, suppliers, and others. When a contract is broken, the injured party may take legal action.

Creating an equal opportunity workplace. Federal law requires businesses to treat all employees equally. Discrimination on the basis of race, gender, age, ethnicity, religion, or disabilities is illegal. Companies have a responsibility to make sure their employment practices—such as hiring, firing, pay, and promotions—are nondiscriminatory.

Protecting whistle-blowers. An employee who reports an employer's misconduct to legal authorities is known as a whistle-blower. In the past, whistle-blowers were often fired for speaking out. However, federal and state laws now protect them from such retaliation.

Ensuring product safety. Businesses are responsible for making sure the products they sell are safe. Federal and state laws govern product safety. When a product is found to be unsafe or defective, the manufacturer may be held liable for any harm it may have caused.

It Is Legal—But Is It Ethical?

In our free enterprise system, businesses are legally permitted to do a great many things. Cosmetics companies may test products on animals. Farmers may use pesticides on crops. Retail stores may pay wages that are too low for employees to live on. But does that mean businesses *should* do these things? On the other hand, there are a great many things that are not required by law—such as giving to charity. But does that mean businesses *should not* do them?

As these questions imply—and as Zuckerberg learned in the Facebook controversy—there is often a difference between what is legal and what is ethically or morally right. This distinction lies at the heart of the growing corporate responsibility movement.

Corporate responsibility is the idea that businesses should take responsibility for the impact of their actions on society. It requires looking beyond a firm's responsibility to its shareholders and considering the needs of its stakeholders. A **stakeholder** is anyone who has an interest in, or is affected by, a company's actions. Stakeholders include employees, customers, suppliers, competitors, and the community in which the business operates.

A growing number of businesses are striving to be good "corporate citizens" by considering the interests of stakeholders. Stonyfield Farm is one example. This organic yogurt manufacturer gives 10 percent of its profits to groups that work to protect the environment.

Many companies address issues of corporate responsibility by creating codes of business ethics. **Business ethics** are principles of right and wrong that guide the actions of a company and its employees.

Visualscope Studios, a company that provides Web site design and search engine services to businesses, created the code of ethics below.

> *We treat our clients and web site visitors with honesty and respect at all times.*
>
> *We honor and respectfully exercise any authority and/or privileges provided to us by our clients.*
>
> *We will be upfront with our rates and fees from the project initiation, so you will be clear on what our roles and expectations are.*
>
> *We will maintain a high level of competence, as well as staying current with new trends in the web design and development industry.*
>
> *We will always work to the best of our abilities to ensure the timely delivery and success of every web project.*
>
> *We will protect sensitive information given by clients and customers as private and confidential.*

Are ethical business practices important to Americans? The answer seems to be "yes." In a 2008 study, people were asked how much they were willing to pay for a pound of coffee based on what they knew about the company's ethical standards. The study showed that they would pay, on average, $9.71 for coffee produced by a company that treated its workers fairly and followed eco-friendly production practices. In contrast, they would pay only $5.89 for a pound of coffee from a company that ignored business ethics. In addition, companies known as socially responsible may have an edge when it comes to attracting a talented and local workforce.

Studies have shown that ethical business practices are important to clients and consumers. Firms with a reputation for high ethical standards also attract talented employees, giving those firms a competitive edge in the market.

At this point in your life, business ethics are probably not something you need to think much about. But as you move into the world of work, that may change. Later on, you will explore the business world from the working person's perspective. You will also learn about human capital, the labor market, and how you might fit into the labor market one day.

Summary

Entrepreneurs are the hardworking visionaries who create new business enterprises. Such enterprises may be sole proprietorships, partnerships, corporations, business franchises, cooperatives, or nonprofit organizations.

What does it take to start a new business? The qualities needed to succeed in business include creativity, determination, and energy. Starting a business is financially risky, but success offers rewards, including unlimited earning potential and a sense of accomplishment.

What kinds of businesses are best organized as sole proprietorships? Sole proprietors tend to be people with a marketable skill who want to work for themselves. They reap the profits and are liable for debts. Small businesses and farms make up the majority of sole proprietorships.

What kinds of businesses are organized as partnerships? In a business partnership, two or more owners share profits and liability. Such businesses may be organized as general, limited, or limited liability partnerships. Family-owned businesses, law firms, and medical practices are common examples of partnerships.

Why are large businesses organized as corporations? The corporation is well suited for a large business because it can sell stock to raise financial capital, thus allowing for growth. It is a legal entity independent of its owners—the shareholders—and can thus exist indefinitely.

What purposes are served by franchises, cooperatives, and nonprofit organizations? Business franchises allow a franchiser to create a distribution network at low cost, while providing business opportunities to franchisees. Cooperatives provide benefits to their members. Nonprofits pursue particular public or private goals but do not operate to make a profit.

What rights and responsibilities do businesses have in a free enterprise system? Businesses have the legal right to advertise, to hire and fire, to screen employees, and to protect intellectual property, among other rights. Legal responsibilities include obtaining licenses and permits, paying taxes, honoring contracts, and using nondiscriminatory employment practices. Many companies have established ethical codes of conduct to guide their actions.