

Chapter 6

Business Ownership and Operations

Learning Objectives

After completing this chapter, you'll be able to:

1. **Name** business ownerships.
2. **Compare** the ownerships.
3. **Describe** alternative ways to do business.
4. **Identify** types of businesses.

Why It's Important

You need to understand business ownerships and operations before starting a business.

Key Words

sole proprietorship
unlimited liability
partnership
corporation
stock
limited liability
franchise
nonprofit organization
cooperative
producer
processors
manufacturers
intermediary
wholesaler
retailer

BusinessWeek Feature Story



Selling Out, Staying On

Grow Your Business by Selling It. Like any other mountain biker at a crossroads, Steve Christini, 28, relies on experience to choose the best path. In deciding which way to go in selling his mountain bike company, he relied on something else: a cold calculation of the chances Christini Technologies

Inc. could ever, on its own, become the big, successful bike manufacturer he dreamed of.

Source: Excerpted with permission from "Selling Out, Staying On," *BusinessWeek Online*, November 6, 2000.

An Extension Activity

After a few teenagers saw your skateboard, they wanted to know where you got it. Fortunately, you and your friends made it. You all decide to manufacture a few of the new skateboards. One friend is the designer, and the other is going to handle marketing. They've asked (and you've agreed) to find investors. How do you go about finding financial investors?



To learn more about Christini's business, visit the *Introduction to Business Web* site at www.introbus.glencoe.com, and click on *BusinessWeek* Feature Story, Chapter 6.

Organizing a Business

Suppose you're a whiz at computer graphics or car repair and want to go into business. How do you want to set it up? Do you want to own and operate it yourself or go into business with a friend? Do you want to run your own multinational corporation? Starting a business is a real challenge. However, it's possible to lower the risk. Careful planning and analysis might help you bring your business right into focus. Consider your own skills, abilities, and potential market for your product or service. Describing your choice and the reasons for it is an important part of your business plan.

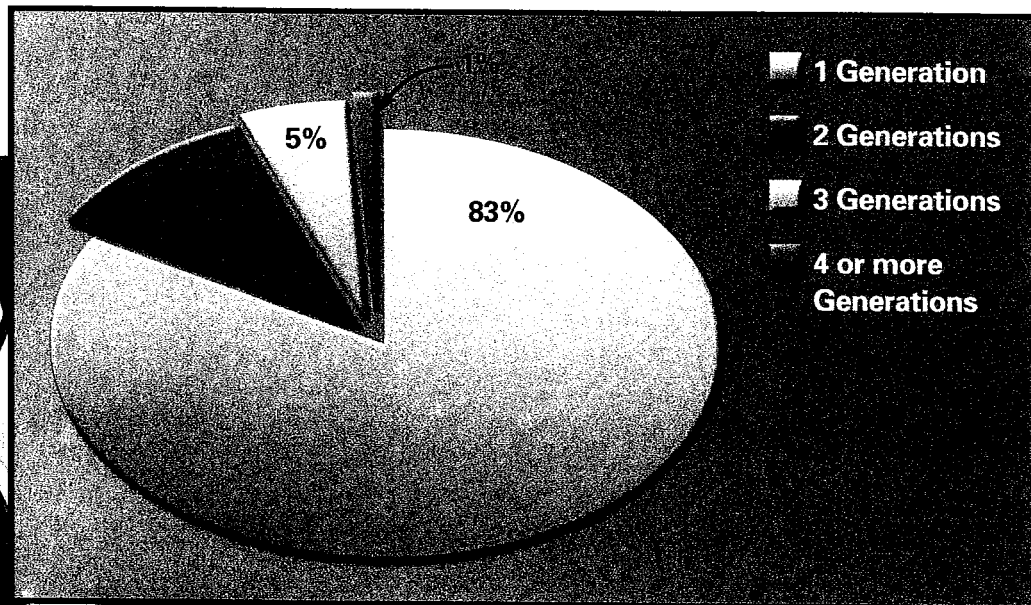
Types of Business Ownership

As your business expands, you might want to change the form of ownership. You have three different ways you can own a business: sole proprietorship, partnership, and incorporation.

GENERATIONS OF FAMILY-OWNED BUSINESSES

➡ Family-owned businesses are sometimes kept in the family for more than one generation.

What percentage of families have had their family-owned businesses for two or more generations?



Sole Proprietorship

A **sole proprietorship** is a business owned by only one person. It's especially suitable if you want to start a business that offers a specific product or service, like a car repair shop. Most bookstores and floral shops are sole proprietorships. So are most farms and home-based businesses. About three-quarters of all businesses in the United States are sole proprietorships. Figure 6.1 shows how many generations of family-owned businesses have been passed on.

Owning your own business is great. First of all, it's easy to start. Depending on the local laws, you might need only a license or permit to start a sole proprietorship. Second, you get to be your own boss. You can come and go as you please and run the business as you see fit. Third, you get to keep all the profits from the business yourself. Finally, the taxes are usually low because you only have to pay them on your personal profits.

On the other hand, there are disadvantages to running your own business. First, you have to pay for everything yourself. You have to buy your own supplies, pay for advertising, rent office space, and pay taxes. You might have to use your personal savings or borrow money from the bank to start your business or keep it going. A lot of sole proprietorships fail because they run out of capital.

You might also lack business skills. You might know everything about car repair but nothing about record keeping or tax preparation. You might need to hire an office manager or accountant to help you run your business.

A serious disadvantage to owning a sole proprietorship is that you have **unlimited liability**, or full responsibility for your company's debts. If you lose more money than you make, you have to make up the difference. You could lose your personal savings, your property, and even your car if your business has debts it cannot repay.

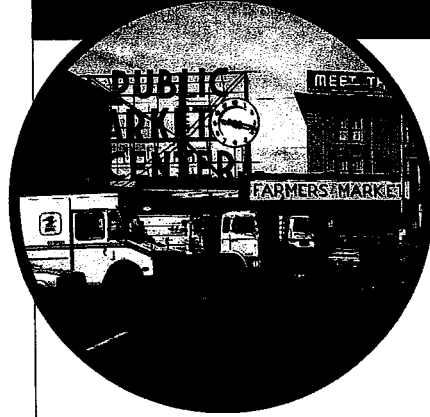
Partnership

Starting a sole proprietorship may sound risky to you. It might seem to be too much work for one person. If you don't have enough money to start a sole proprietorship, you could go into business with a partner. You could bring the idea and your partner could find the money. A **partnership** is a business owned by two or more persons who share the risks and rewards. More owners can contribute to the business. All partners who share in the business have good reason to work hard for its success, since they share the rewards. Like the income of a sole proprietorship, the income of a partnership is taxed only once.

To start a partnership you need to draw up a partnership agreement, which is a contract that outlines the rights and responsibilities of each

Real-World Application

part **1** of 4



CAUTION: LOW-FLYING FISH

Nestled between the Waterfront on First and Pike, you'll find Seattle's famous Pike Place Market. Merchants, travelers, and regulars have frequented this open-air market since 1907. In 1973 the Pike Place Merchants Association (PPMA) became officially incorporated as a nonprofit membership organization.

What's the aim of joining forces and starting an organization?

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partner. If you decide to start a car repair business with your friends, Thelma and Ray, you need to agree on certain things. For example, how much money will each of you invest, and how will you share the profits? You also need to specify how to share the work and how to end the partnership. If Ray decides to leave the business, the partnership legally ends. Your partnership agreement should provide a way to buy Ray's share of the business so the business can continue.

There are several advantages to a partnership. Like a sole proprietorship, you might need only a license to start and have to pay taxes only on your personal profits. Unlike a sole proprietorship, it's easier to obtain capital. Each of your partners can contribute money to start the business. Banks are often more willing to lend money to partnerships than sole proprietorships.

Your partners can also bring different skills to the business. You might be best at fixing cars, Thelma at running the office, and Ray at getting new customers. The business can run more efficiently and each partner has an incentive to do a good job.

There are several disadvantages to a partnership. You not only share the risks with your partners, you also share the profits. You might not get along with Ray or Ray might decide to leave the business. In that case, you have to end the partnership and reorganize the business.

You also share unlimited legal and financial liability with your partners. If one partner makes a bad decision, all partners are equally responsible. A bad decision by one partner can result in the business losing money. All partners are responsible for debts that result from the person's bad decision. If Ray loses the company money by buying bad equipment, you have to share the debt. If Ray does something really

You Make the Call

Going Solo or Partnering Up?

It was raining one Thursday last November, so you and your best friend, Jeremiah, decided to try an experiment. You cooked up some packaging "peanuts" on your mother's stove and discovered they turn into a gummy matter that works wonders to cure a leaky faucet. You decide you'd like to sell some of this caulking material, which you'll call "Peanut Better." Jeremiah hears you talking to your business teacher about the new business and says he wants to be a partner.

Making an Ethical Decision

1. What are the advantages and disadvantages of "going solo" in a business venture?
2. How can having a partner help launch and grow a business? Are there any drawbacks?
3. Since Jeremiah was involved in the initial experiment, do you have an obligation to invite him to be a partner? What if he had been the one who decided to start the business without you?

stupid, like buying stolen equipment, you could end up sharing a jail cell with him.

Corporation

Suppose your car repair business has grown and you want to add more shops or buy new equipment. You need more capital but you don't want to borrow more money or bring on new partners. What you can do is form a corporation.

A **corporation** is a business owned by many people but treated by law as one person. It can own property, pay taxes, make contracts, and be sued just like a person. However, it exists separate from its owners.

To form a corporation, you need to get a corporate charter from the state your headquarters is in. A corporate charter is a license to run a corporation.

To raise money, you can sell **stock**, or shares of ownership in your corporation. The new owners (or stockholders) pay a set price for each share. For each share of common stock, the stockholder gets a share of the profits and a vote on how the business is run.

You also must have a board of directors who control the corporation. They don't actually run the day-to-day business operations of the company but they hire officers to do it. You get to pick the first board of directors, but each year the stockholders get to vote on them.

A major advantage of a corporation is its **limited liability**. If your company loses money, the stockholders lose only what they invested. Since your corporation exists separately from you, if it goes out of business you can't have your personal property or savings taken away from you.

Another advantage is that the corporation doesn't end if the owners sell their shares. As long as your business makes money, you can continue the company by reselling the shares. You can also raise more capital at any time by selling new shares.

A disadvantage of a corporation is that you often have to pay more taxes. The federal government and some state governments tax corporate profits. The owners are taxed on their income from the corporation. The corporation itself has to pay taxes. The government also closely regulates corporations. It's more difficult to start a corporation than a sole proprietorship or a partnership and running it can be much more complicated.

Real-World Application

part **2** of 4



CAUTION: LOW-FLYING FISH

At 86 Pike Place, you'll find the world-famous fish-flingers at Pike Place Fish. In 1965 John Yokoyama purchased it because he needed the money to make his car payments.

What's the benefit of going into business for yourself?

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Fast Review

1. What are some of the advantages of a sole proprietorship?
2. What is the difference between a sole proprietorship and a partnership?
3. If a partner makes a bad business decision, what responsibility do the other partners have?
4. What are the disadvantages of a corporation?

Alternative Ways to Do Business

You might find it easier to start a business with the help of an established company. You could also start a business by pooling your resources with other businesses. Maybe you're more interested in providing a service to your community than you're into making a profit. Franchises, cooperatives, and nonprofit organizations offer you other ways to do business.

Franchise

A **franchise** is a contractual agreement to sell a company's products or services in a designated geographic area. You probably have several franchises in your neighborhood, such as Taco Bell. If you decide to open a Blockbuster video store, you're the franchisee. Blockbuster, the existing or parent company, is the franchisor.

To run a franchise you have to invest money and pay the franchisor an annual fee or a share of the profits. In return, the franchisor offers a well-known name and a business plan. It provides management training, advertising, and a system of operation. You can operate a franchise yourself, as a sole proprietor, as a partnership with someone else, or even as a corporation.

An advantage of opening a franchise is that it's easy to start. You can rely on the proven methods and product of the parent company. The name of the parent company can be a big draw for customers. When someone wants to rent a video, they often go to the nearest Blockbuster store.

The disadvantage of running a franchise is that the franchisor is often very strict about how the business is run. Your business must operate like every other franchise. You might be limited in what products or services you can offer your customers. If you want to start a business but lack business know-how, however, you might want to choose a franchise.

Nonprofit Organization

Not everyone goes into business just to make a profit. You might want to start a business whose main purpose is to help children, the poor, local artists, or animals. A **nonprofit organization** is a type of business that focuses on providing a service rather than making a profit. The Children's Television Workshop, the American Red Cross, and Meals on Wheels are nonprofit organizations. Private hospitals, schools, and museums can also be set up that way.

Like a corporation, a nonprofit organization has to register with the government and might be run by a board of directors. Because it doesn't make a profit, however, it doesn't have to pay taxes. Instead of investors, nonprofit organizations rely on government grants and on donations from businesses and individuals. Donors don't receive dividends like investors, but they can deduct their donations from their taxes.

Consider This...

Manufacturing Products

Compaq Computers and Cisco Systems don't build their own products anymore. These companies rely on Flextronics, a company that specializes in manufacturing electronics, to build their equipment. This allows Compaq and Cisco to focus on creating new products. Flextronics has grown into a global contractor that produces \$10.5 billion a year in electronic gizmos.

ANALYZE

What do Compaq Computers and Cisco Systems give up when they rely on an outside manufacturer?

Cooperative

A **cooperative** is an organization owned and operated by its members for the purpose of saving money on the purchase of certain goods and services. For example, Ocean Spray is a cooperative of cranberry growers. A cooperative is like a corporation in that it exists as a separate entity from the individual businesses. You also need a government charter to start one. Like a corporation, a cooperative can also sell stock and choose a board of directors to run it.

With a cooperative, small farmers, book dealers, or antique merchants can pool their resources. They can save money by buying insurance, supplies, and advertising as a group. They can share factory facilities and warehouse space. Cooperatives also pay less in taxes than regular corporations do. Other examples of cooperatives are Ace Hardware and Welch's.



Fast Review

1. What are some examples of franchise businesses?
2. What types of assistance does the franchisor give a franchisee?
3. How is a nonprofit organization like and unlike a corporation?
4. What are some advantages of a cooperative?

Types of Businesses

After school you go to a fast-food restaurant with some friends to get a hamburger. Before you take a bite out of that burger you might stop to consider how much work it took to get it to you. Selling it over the counter is the tip of the iceberg. Before that the food had to be grown, processed, manufactured, refined, transported, and stored by different types of businesses.

There are many different types of businesses and different ways to classify them. One way is to group them by the kind of products they provide:

- producing raw goods
- processing raw goods
- manufacturing goods from raw or processed goods
- distributing goods
- providing services

Producers

A **producer** is a business that gathers raw products in their natural state. Raw goods are materials gathered in their original state from natural

Real-World Application

3



CAUTION:

LOW-FLYING FISH

Pike Place Fish didn't become world famous by advertising. (Instead a Spike Lee Levi's commercial, NBC's *Frasier*, and MTV's *Real World* helped expose the market.) Pike Place prides itself on interacting with the people. The staff wants to give each person a memorable experience.

Can a business have a contractual agreement with its customers?

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resources such as land or water. A farmer who grows wheat in Kansas is a producer. So is a miner who digs for iron ore in Minnesota and a petroleum worker who drills for crude oil in Alaska. Industries that are producers include agriculture, mining, fishing, and forestry. Business firms that perform activities of this sort are producers of raw goods.

Processors

Most of the time we don't use raw goods in the same form they're found in nature. **Processors** change raw materials into more finished products. They're involved in the processing of raw goods. Processing goods are made from raw goods that may require further processing. For example, wheat is turned into flour, crude oil into gasoline, and iron ore into steel. Paper mills, oil refineries, and smelting plants are types of businesses that process raw goods. Their products, processed goods, are made from raw materials that may require further processing.

Working Lifestyle

What are you doing at 10 A.M.?



The Fast-Paced Circle

"Just when you become an expert on a system, everything changes again and you start learning all over again," says Sunny Kim. This applications specialist for 21st Century Insurance tries to balance a fast-paced career, her family, and attending continuing education courses.

"It's a vicious cycle of knowledge," Kim says. "There's always a challenge to learn a new system and to be aware of how things might change." That's why it's especially important to specialize in one area. Then together with a team of other technology specialists, they interact and contribute to the company's information network.

At 10 A.M. Kim and the other system experts discuss the tasks for the week. Today it's about data storage—they're the ones who will continue creating the "paperless processing" environment. Information never stops. She makes it seamlessly arrive on time for the company to utilize.

Salary

The median income for an applications specialist is \$40,000, with a range between \$38,000 and \$50,000.

Outlook for This Career

This job group is expecting rapid growth among all computer-related occupations.

Connecting Careers Activity

What other occupations require working in a fast-paced environment?

CAREER PATH



Manufacturers

Manufacturers are businesses that make finished products out of processed goods. They turn raw or processed goods into finished goods that require no further processing and that are ready for the market. A bakery makes bread out of flour. An automotive plant makes cars out of steel, glass, and plastic. A furniture factory makes tables out of lumber. Many of the leading businesses in the United States are manufacturers; others are producers and processors. Boeing, Pepsi Co, General Electric, Procter & Gamble, and Eastman Kodak are examples of leading manufacturers in their industry.

Intermediaries

An **intermediary** is a business that moves goods from one business to another. It buys goods, stores them, and then resells them. A **wholesaler**, also known as a distributor, distributes goods. Wholesalers buy goods from manufacturers in huge quantities and resell them in smaller quantities to their customers, usually other companies. The clothing wholesaler, for example, may buy thousands of jackets from several manufacturers. The wholesaler then divides the large quantities into smaller quantities and sells them to retailers. A **retailer** purchases goods from a wholesaler and resells them to the consumer, or the final buyer of the goods. It's another type of business that moves goods. Service stations, record stores, and auto dealers are examples of retailers.

Service Businesses

Service businesses provide services rather than goods. Goods are material products such as cars, CDs, and computers. Services are the products of a skill or an activity such as hairstyling and car repair. Some service businesses meet needs, such as medical clinics and law firms. Some provide conveniences, such as taxi companies and copy shops. Newspapers and Internet services, such as Yahoo!, give us access to information. Service businesses employ about three-quarters of the workforce and are rapidly increasing in numbers.

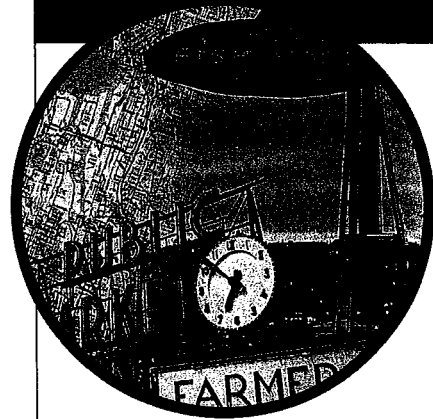


Fast Review

1. What is the difference between a producer and a processor?
2. What does a manufacturer do with raw or processed goods?
3. What does an intermediary do?
4. Give examples of service businesses.

Real-World Application

part 4 of 4



CAUTION: LOW-FLYING FISH

Yokoyama has such a strong desire to empower other business leaders that he's formed a consulting team. His commitment to his people and his customers is one model other businesses are learning in corporate training videos. **What area does Pike Place Fish focus on other than fish?**

Chapter 6 Review

Summary

1. Three types of business ownership are sole proprietorship, partnership, and corporation.
2. Each type of business ownership has its advantages and disadvantages. A sole proprietorship is easier to start than a partnership or corporation. On the other hand, it's easier to obtain capital if you're in a partnership rather than a sole proprietorship. Corporations are more difficult to start than sole proprietorship and partnership.
3. A franchise, nonprofit organization, and cooperative are alternative ways of doing business.
4. Producers, processors, manufacturers, intermediaries and service businesses are types of businesses that treat products differently.

Using Business Key Words

Complete each sentence with the correct term.

- | | |
|--------------------------|-----------------|
| • sole proprietorship | • wholesaler |
| • partnership | • processors |
| • corporation | • manufacturers |
| • intermediary | • franchise |
| • cooperative | • producer |
| • unlimited liability | • retailer |
| • limited liability | • stock |
| • nonprofit organization | |

1. A _____ is a business organization with two or more owners who share the risks and rewards.
2. Shares of ownership in a corporation are called _____.
3. A _____ buys and resells goods.
4. A business owned by one person is called a _____.
5. A business that is treated by law as a separate entity is a _____.
6. Businesses that change raw goods into more finished products are called _____.
7. _____ turn raw or processed goods into finished products.
8. _____ is full legal and financial responsibility for a business.
9. _____ is financial responsibility only for what the owners of a corporation have invested.
10. A contractual agreement to sell a company's products or services in a designated geographic area is a _____.
11. A business whose main purpose is to provide a service rather than to earn a profit is called a _____.
12. _____ is a group of small businesses banded together into a type of corporation.
13. A _____ is a business that gathers raw products in their natural state.
14. A type of business that buys goods in large amounts and resells them to other businesses in smaller lots is called a _____.
15. A type of business that buys goods from wholesalers or manufacturers and sells them directly to the public is called a _____.

Chapter 6 Review

Review What You Learned

16. List four advantages of a business organized as a sole proprietorship.
17. How many people must be involved in a partnership? Is there a limit on the number of partners a business can have?
18. Sole proprietorships and partnerships both have unlimited liability for their business debts. What does that mean to the owners?
19. What happens when a partner leaves the business or dies?
20. What is the major advantage of a corporation? Explain your answer.
21. Describe the differences between producers, processors, manufacturers, and intermediaries.
22. What is another name for an intermediary?
23. Currently, service businesses employ what percentage of the workforce?

Understanding Business Concepts

24. What do you consider to be the biggest disadvantage of a sole proprietorship?
25. Why would two or more people decide to form a partnership instead of forming a sole proprietorship with one of them as the owner?
26. There are more sole proprietorships than partnerships or corporations in the United States. Why do you think so many businesses are organized this way?
27. What is the major way a corporation is different from a sole proprietorship or partnership?
28. Give three examples each of raw goods and processed goods.
29. Think of one of your favorite food products. Describe the raw materials that make up the food, how it might have been processed and then manufactured into the food you enjoy.

Critical Thinking

30. Which of the types of businesses described in this chapter would have the easiest time obtaining money to expand their business? Why?
31. Why do many people believe that profits on sales of finished goods are much higher than they actually are?
32. Describe the steps involved in making a hamburger.
33. Have you ever purchased a defective product? Did you exchange or return the product? Do you think the defective product cost the producer money? Why or why not?



Viewing and Representing

Examining the Image. Describe the contents of this photograph. What does the photographer want the viewer to think or feel? If you and your family ran a wholesale bait business, would you run it as a sole proprietorship or as a corporation? Why? What kind of wholesale business would you be interested in running?

Chapter 6 Review

Building Academic Skills

LANGUAGE ARTS

Profiling an Owner

Interview a local sole proprietor about what he or she enjoys and finds difficult in running his or her own business. Discuss the advantages and disadvantages of a sole proprietorship with the owner, then write a profile of the business owner.

COMPUTER TECHNOLOGY

Charting and Comparing

Suppose you have \$1,000 to invest. Check the stock listings in your newspaper and choose one or more corporations in which to invest your money. Follow the daily progress of your own stock in the newspaper for one week. Then use graphing software to create a graph showing whether your stock went up or down in value. Compare your stock selection with others in your class.

MATH

Percentage

The neighborhood bakery makes bread, cakes, cookies, and pies. At the end of the day, all the leftover products are reduced by 75 percent. What will the reduced prices be for the following:

| | |
|-------------------------|--------|
| Bread | \$3.49 |
| Chocolate cake | \$6.99 |
| One dozen sugar cookies | \$3.99 |
| Apple pie | \$4.75 |

Social Science

Research

In a group, prepare a bulletin board or a large chart tracking the route of an item from raw material to the consumer product. On the display, showcase the country or countries that have been a part of the process.

Linking School to Home

Inventory and Interview. Create an inventory of the products and services you and your family use that are produced by small businesses or entrepreneurs. Categorize them by family member. Then, interview each family member and find out why he or she purchases the products and services from the small business or entrepreneur. Compile your results and share them with the class.

Linking School to Work

Guest Speakers. Invite local businesspersons representing sole proprietorships, partnerships, and corporations to serve on a panel discussion in your class. Ask them to share:

- advantages and disadvantages of each type of business ownership
- how they got their start
- qualities they feel are important to the success of the particular type of business ownership they represent

Have questions ready when the panel members arrive. Be sure to thank them for their time.

Chapter 6 Review

E-Homework

Applying Technology

Convenient Technology. Computers, personal digital assistants, pagers, and cell phones are tools routinely used in the business world today. Explain whether this technology is as critical to the sole proprietor as it's to a corporation with many stockholders.

Creating a Database. Compile a database of local businesses in which you include fields for the name, address, the telephone number, and the category of business—producer, processor, manufacturer, or intermediary. Use the local Yellow Pages to locate the information. Try to find at least one business in each category and include a minimum of ten businesses. Print out your database. If you can't find a local business in one of the categories, explain why you think this might be so.

Connecting Academics

Math. Draw a circle graph to give a visual representation comparing percentages of the forms of ownership of small businesses. Use the following statistics: corporations 22 percent, partnerships 7 percent, and sole proprietorships 71 percent. Color your graph. What is the most popular form of business ownership? What might be the reason for this?

Language Arts. What interests you most? Choose a form of business ownership or a type of business—from producers to service businesses—to research important details. Create a visual display connected to your chosen topic. Present an oral report to your class.

BusinessWeek

Analyzing the Feature Story



You read the first part of “Selling Out, Staying On” at the beginning of this chapter. Below are a few questions for you to answer about Christini’s business. You’ll find the answers to these questions

when you’re reading the entire article. First, here are the questions:

34. What made Christini’s business idea suitable for a sole proprietorship?
35. What disadvantage of sole proprietorships was behind Christini and other sole proprietors’ decisions to sell their company?

CREATIVE JOURNAL ACTIVITY

An alternative form of business to a sole proprietorship or corporation is a franchise. What questions do you have about how a franchise is run?

BUSINESS Online The Full Story

To learn more about Christini’s business, visit the *Introduction to Business* Web site at www.introbus.glencoe.com, and click on *BusinessWeek* Feature Story, Chapter 6.