

# 3 chapter

## **The Classification of Business Organization**

**Introduction to Business**  
**DBB 1213**

# **Instructor Lecture PowerPoints**

# LEARNING OBJECTIVES

After reading this chapter, you should be able to:

1. Define **small business**, discuss its importance to the U.S. economy, and explain popular areas of small business.
2. Explain sole proprietorships, partnerships, and cooperatives and discuss the advantages and disadvantages of each.
3. Describe corporations, discuss their advantages and disadvantages, and identify different kinds of corporations.
4. Explain the basic issues involved in managing a corporation and discuss special issues related to corporate ownership.



# What Is a “Small” Business?

- Small Business Defined
  - A business that is independent (not part of a larger business) and that has relatively little influence in its market.
- The Importance of Small Business in the economy
  - Job creation
  - Innovation
  - Contributions to big business
    - Suppliers of raw materials (farmer supplying fresh product)
    - Sellers of larger firms’ products (grocery stores)

# Starting the Small Business

Two ways to start a small business is:

1. Start from Beginning
2. Franchising





# Starting the Small Business

- Starting from Beginning
  - Advantage: Avoids problems of an existing business
  - Disadvantage: Higher risk of business failure
- Questions to Be Answered:
  - Who and where are my customers?
  - How much will those customers pay for my product?
  - How much of my product can I expect to sell?
  - Who are my competitors?
  - Why will customers buy my product rather than the product of my competitors?



# Starting the Small Business

- Franchising
  - Type of license that a party acquires to allow them to have access to a business's proprietary knowledge, processes and trademarks in order to allow the party to sell a product or provide a service under the business's name
  - In exchange for gaining the franchise, the franchisee usually pays the franchisor initial start-up and annual licensing fee



# Franchise

## Advantages

- Higher rate of success than start-up businesses.
- Have an established reputation and image, proven management and work practices, access to national advertising and ongoing support.

## Disadvantages

- Ongoing payments to the franchisor
- Management rules and restrictions on the franchisee
- Less room for creativity

# Franchisor and Franchisee

**Franchisor** – A person or company that grants the license to a third party to conduct the business.

The franchisor owns the overall rights and trademarks of the company and allows its franchisees to use these rights and trademarks to do business.



# Franchisor and Franchisee

**Franchisee** – The party that purchase the right to use a business's trademarks, brands and other proprietary knowledge in order to open a branch.

In addition to paying an annual franchising fee to the company, the franchisee must also pay profits to the franchisor.



# Examples of Top Franchise Brand





# Reasons for Failure and Success

- Failure
  - Poor management
  - Neglect
  - Weak leader and control systems
  - Insufficient capital
- Success
  - Hard work, drive, and dedication
  - Market demand
  - Managerial competence
  - Luck



# Business Ownership

- Three forms of Legal Ownership
  - Sole proprietorship: Owned and operated by one person
  - Partnership: Contract between two or more people to start business and share profits or losses
  - Corporation
- Choice of Ownership Form
  - Based on the entrepreneur's needs/desires for control, ownership participation, financing sources, and appropriateness of the chosen form for the industry in which the firm will compete



# Sole Proprietorships

- **Sole proprietorship** is owned and run by one natural person
- The simplest business form under which one can operate a business.
- The sole proprietorship is not a legal entity. It simply refers to a person who owns the business and is personally responsible for its debts.

# Sole Proprietorships

## Advantages

- Freedom
- Simple to form
- Low start-up costs
- Tax benefits

## Disadvantages

- Unlimited liability:  
Owners are responsible  
for all debts of a  
business
- Limited resources
- Limited fundraising  
capability

# Partnerships

- General Partnerships

- A general partnership is an arrangement by which partners conducting a business jointly have unlimited liability, which means their personal assets are liable to the partnership obligations.
- They pool their talent and money and share all profits or losses

- Limited Partnership

- Allows for **limited partners** who invest money but are liable for debts only to the extent of their investments
- Must have at least one **general (or active) partner**, who is usually the person who runs the business and is responsible for its survival and growth



# Partnerships

## Advantages

- More talent and money
- More fundraising capability
- Relatively easy to form
- Limited liability for limited partners
- Tax benefits

## Disadvantages

- Unlimited liability for general partner
- Disagreements among partners

# Corporations

- Corporation
  - Legal entity that is separate and distinct from its owners.
- Corporations may:
  - Be small or large
  - Sue and be sued
  - Buy, hold, and sell property
  - Make and sell products
  - Have limited liability for individuals who form it.





# Corporations

## Advantages

- Limited liability: The owners' responsibility for the debts of a business is limited to their investment in a business
- Continuity
- Stronger fundraising capability

## Disadvantages

- Tax
- Complicated and expensive to form

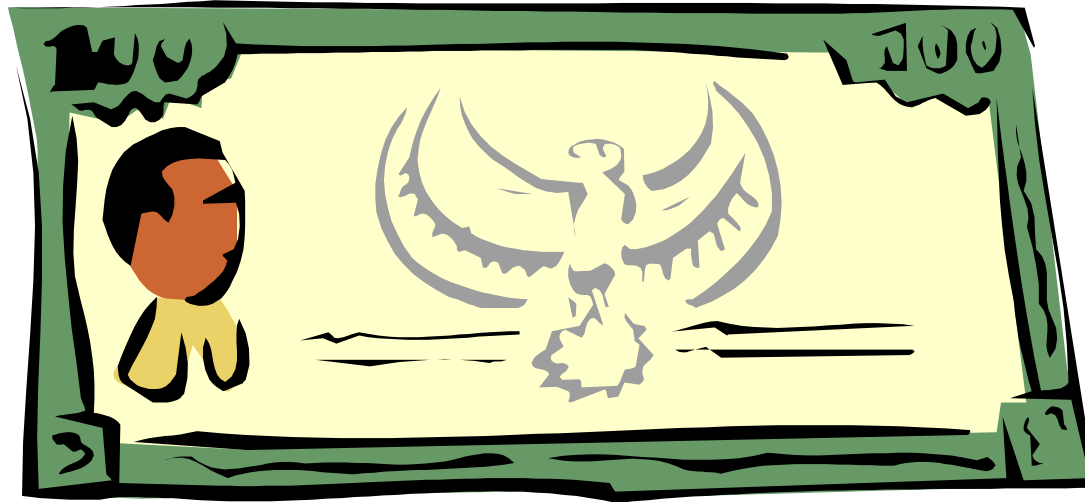


# Managing a Corporation

- Corporate Governance
  - Corporate governance is established by the firm's bylaws and involves three bodies:
    - **Stockholders / shareholders:** Investors who buy ownership shares in the form of stock
    - The **board of directors:** Group elected by stockholders to oversee corporate management
    - **Corporate officers:** Top managers hired by the board to run the corporation

# Stockholders: Owners of Corporations

- Stock: A share of ownership in a corporation
- Dividends: Profits distributed among stockholders





# Special Issues in Corporate Ownership

- Mergers, Acquisitions, and Divestitures
  - **Merger:** Two firms combine to create a new company
  - **Acquisition:** One firm buys another outright
  - **Divestiture:** Strategy whereby a firm sells one or more of its asset for financial reason

# Main Departments in Corporation

