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Chapter Three

INTRODUCTION TO ENTREPRENEURSHIP

TYPES OF BUSINESS OWNERSHIP

Module Name: Entrepreneurship and Leadership
Cohort: Year 3- BSc(Hons) Software Engineering

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The Main Idea

- Entrepreneurs need to understand the advantages and disadvantages of various forms of businesses so they can choose the most appropriate form for their business.

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Sole Proprietorship

- The easiest and most popular form
  - Owned and operated by one person
  - Nearly 76% of all businesses in the U.S. are sole proprietorships
  - Owner receives the profits, incurs any losses, and is liable for the debts of the business
    - May start as a sole proprietorship and then switch to a form that provides more personal financial protections as the business grows

Features of a Sole trader

- Sole Proprietorship
- Simple legal formalities
- Unlimited liability
- Freedom of actions
- Quick decisions without the need to consult others

Sole Proprietorship

Advantages

- Easy and inexpensive to create
- Gives owner complete authority over all activities
- Least regulated form of ownership
- Business and owner are not taxed separately

Disadvantages

- Owner has unlimited liability
  - Fully responsible for all debts and actions of the business
  - Owner's personal property is at risk if financial issues not managed properly
    - Home, car and personal bank accounts
  - No partners to help make important decisions
  - Owner may have limited skills
  - Work hours are long and irregular

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Setting up a Sole Proprietorship

- As a sole trader there is **no legal distinction** between **you** and **your business**.
- Your **business** is one **of your assets**, in the same way that your house or car is an asset.
- It follows from this that if your business should **fail** your creditors have a right not only to the assets of the **business**, but also to **your personal assets**, subject only to standard bankruptcy provisions **(these often allow you to keep only a few absolutely basic essentials for yourself and family).**

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Setting up a Sole Proprietorship

- The capital to start and run the business must come from you or from loans. There is no access to equity capital, which has the attraction of being risk-free.
- Offsetting the drawbacks is the fact that you can be your own boss immediately subject only to declaring your profits on your tax return and, if necessary, applying for a trade licence if your chosen line of business requires it.

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10 Steps to launch your own business in Mauritius

- Today, youths are advised to consider entrepreneurship for their career instead of looking for a job, but many of us do not know what are the steps to be taken to start a business. The Small and Medium Enterprises (SMEs) is a parastatal body under the aegis of the Ministry of Business Enterprises and Cooperatives, which promote and develop entrepreneurship in Mauritius.

10 steps identified by SMEs to launch your own business in Mauritius:

- **Step 1: Conception of project/Business idea**
- Project profiles are available at the SME Documentation centre

- **Step 2: Preparation of business plan**
- Format of business plan is available at SME

- **Step 3: Deciding on form of business**
- Sole trader/ Partnership/ Company/ Co-operative Society

- **Step 4: Choosing the right location**
- Home based business/ Rent/ Purchase/ land lease

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STEP 5 AND 6

- **Step 5: Registering the business**
- The business should be registered with:
- Registrar of Businesses
- c/o Registrar of Company
- One Cathedral Square Building
- Jules Koenig Street, Port-Louis
- Tel: 211-4460 Fax: 208-7263
- Email: rocd@intnet.mu

- **Step 6: Apply for Registration with SME**
- Small Enterprise Certificate: Enterprise having an annual Turnover not exceeding Rs 10 M
- Medium Enterprise Certificate: Enterprise having an annual Turnover of more than Rs 10 M but less than Rs 50 M.

Step 7, 8

- **Step 7: Apply for Building and Land Use Permit (BLP) with local authority**
- Check with Planning Department of Municipality (urban area) or District Council (rural area) whether a Building and Land Use Permit (formerly Development permit & Building permit) is required to start your proposed business.

If YES,

- Check which guidelines would be applicable
- What is the zoning and policies applicable to your site as per provisions of the outline scheme.
- **Step 8: Financing the project**
- Banks (Development Bank of Mauritius Ltd- DBM, Commercial banks etc.) / Leasing companies
- Venture Capital (Quasi-Equity, SME Partnership Fund Ltd)

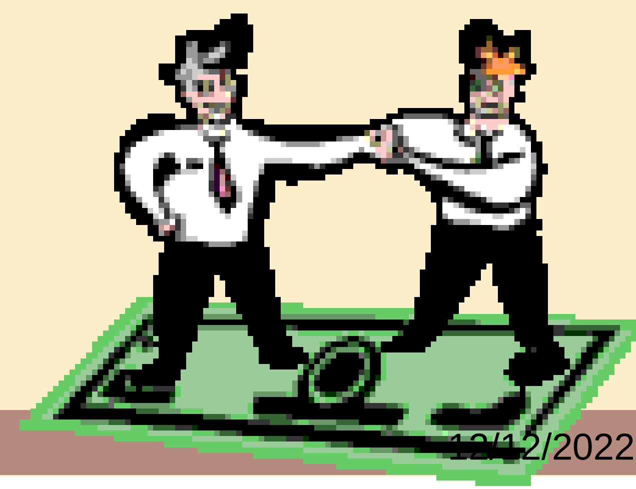
Step 9 and 10

- **Step 9: Implementing the project**
- Pay trade fee with local authority
- Recruit people/ purchase equipment, raw materials, accessories etc.
- Install machinery, equipment and furniture/ Verify systems in place to ensure safety

- **Step 10: Planning and Organising Business Activity**
- Procurement/ stores/ Production
- Sales/ Advertising and Marketing
- Finance/ Human Resources
- Office and Administrative Work

Partnerships

- An unincorporated business with two or more owners
  - Most common business organization involving more than one owner
    - Share the decisions, assets, liabilities and profits



Partnership – Pros and Cons

Advantages

- Inexpensive to create
- General partners have complete control
- Share ideas
- Share responsibility
- Share liabilities
- More financial resources
- Easier to get loans

Disadvantages

- Difficult to dissolve one partner's interests
- Personality conflicts
- Disagreements over authority
- Partners can be held liable for each other's actions
  - Example if one partner signs a contract with a supplier, the other is bound by the terms of the contract as well

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Making a Partnership Work

- Plan for disagreements
  - Greatest chance of surviving when:
    - Share business responsibilities
    - Put things in writing
    - Be honest about how the business is doing
    - Establish a partnership agreement in advance
    - Consult an attorney to draft your agreement

Limited Liability Company or LLC

- Owners and managers enjoy limited liability and some tax benefits.
  - members of the corporate structure are not personally liable for the debts and obligations.
- Avoid some restrictions associated with other corporations.
- It is the combination of both the features of sole proprietorship or partnership and corporation.
- The owners of the beneficial rights are called "members" rather in normal terms "shareholders".

Limited Liability Company or LLC

Advantages

- Simpler to set up than a corporation
- Allows for flexibility of a partnership structure
- Protects owners with limited liability
- Members are not liable for the company's debts
- Not subject to double taxation
- No limitations on the number of members

Disadvantages

- More work to set up than a sole proprietorship or a partnership
  - Every state has different requirements for forming a LLC
    - Check with state officials for rules and regulations

Corporations

FedEx Corporation

A corporation is owned by shareholders, and their ownership is represented by shares of stock.

A **corporation** is a legal entity that is **separate** and distinct from its owners.

A corporation has a **board of directors -** a group of people elected by the shareholders to oversee the corporation's management.

Lives on after the owners have sold their interests or died

Corporations enjoy most of the rights and responsibilities that individuals possess:

- they can **enter contracts**,
- **loan and borrow money,**
- **sue and be sued, hire employees,**
- **own assets and pay taxes.**

3 main types:

- C-corporation,
- subchapter S corporation and
- nonprofit corporation

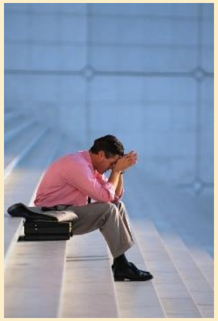
Corporations

Advantages

- Status and professional appearance
- Limited liability
- Perpetual life
- Ability to raise investment money
- Employee benefits
- Tax advantages
- Limited liability
  - Individuals only risk their individual investment

Disadvantages

- Expensive to set up
- Income is more heavily taxed
  - Subject to double taxation
    - Corporation pays taxes on profits then stockholders pay taxes on dividends they receive from those earnings



CONVENTIONAL (C) CORPORATIONS

A legal entity with authority to act and have **liability separate** from its **owners** (its stockholders).

A C-Corp is the standard form for corporations and mostly **large businesses** are **C-Corps**.

C corporation, is a separate legal entity owned by shareholders.

You form the corporation by filing incorporation documents with a state and paying the related filing fees. The corporate structure limits each owner's (shareholder's) personal liability for the corporation's business debts to the amount invested in the company by the shareholder.

Examples of Most Common Corporations

Amazon.	Google	Domino's Pizza.	Walmart.
Microsoft	Apple.	ABC Banking Corporation	Indian Oil Corporation Ltd.
Human Resource Development Council (HRDC) Mauritius Broadcasting Corporation Bank of Mauritius (Central Bank for Corporate Governance)			

C-Corporations

- C-Corporations are **taxed** on profits that the company makes.
- When the company distributes its earnings to its owners in the form of either **dividends** or **special payouts**, the individual owners are **also taxed** on this income.
- As a result, C-corporations can be subject to having their income **double taxed**.

This is an important thing to consider when deciding how to incorporate your business, as there could be a significant additional tax expense incurred if proper steps are not taken to limit the implications of double taxation.

C-Corporations

- Generally, all for-profit corporations are automatically classified as a C corporation.
- A corporation may qualify as a C corporation if it has **unlimited number of shareholders**. Shareholders can be both **foreign** or **domestic**.
- Any distribution from the earnings and profits of a C corporation is treated as a **dividend**.
- Because **C corporations** enable a business to have an unlimited number of shareholders, most **publicly traded companies** are **C corporations.**

How to Set up a C Corporation

C Corporation has multiple **classes of stock** means your C **corp can** accept investments from individuals, partnerships, or other **corporations**.

Flexible shareholder voting:

C **corporations can** issue **multiple classes of stock with different** voting rights.

THE COMPANIES ACT

APPLICATION FOR INCORPORATION OF A COMPANY
[Section 23(1)(a)]

Create Date	16/09/2013
Job Number	130916RC12869MNSRC
Status	Complete

Date of Incorporation		Company Number	

Name of proposed company	test16 *	Registered Names	
Category	Domestic company *	Nature	◉ Private ○ Public *
Type	Limited by shares *	One Person Company	○ Yes ◉ No *
Limited Life company	◉ Yes ○ No *	Duration	2 * (years, if limited by life)

Registered Office Address

Street	test16 *
Building/Locality	
Town/Village	
Country	MAURITIUS

Director * | Shareholder * | Member | Secretary | Registered Agent | Supporting Documents

Please give your instructions regarding the Certificate of Incorporation :

Fax ☐ Fax No.

Collection Method	◉ Will Collect ○ Send By Registered Post *
Address to post to	○ Registered Office ○ Principal Place of Business ○ Address for Correspondence ○ Contact Address

Request for certified copies :

Certified copy of certificate for incorporation	0
Certified copy of the application for Incorporation	☐ No. of copies

** Chargeable* *View Fees*

Note : For overseas fax please specify country and area codes

C Corporation

Pros of C-corporation

- **Owners have limited liability.** The owners' assets are protected from the debts and liabilities of the corporation. Shareholders are not held liable for business losses.
- **Easier to raise capital.** It is easier to attract capital with the sale of stocks and bonds. A corporation can have an unlimited number of investors.
- **Easy to transfer ownership.** Shares of stock can be sold.
- **Corporations have perpetual lifetimes.** The entity continues to exist beyond the deaths of the owners.
- **Certain expenses are tax deductible.** Owners can receive tax-free benefits such as deductions for retirement plans and insurance.

Cons of C-corporation

- **Double taxation of corporation profits.** The corporation pays federal and state taxes on its profits. When dividends are paid to shareholders, they are treated as income and taxed again.
- **Forming a corporation costs more.** Attorneys charge more to form a corporation.
- **More state and federal regulations and oversight.** Tax filings are more complicated for corporations. States require the filing of Articles of Incorporation, corporate by laws and annual reports. Corporations must designate a board of directors and hold annual meetings.

S CORPORATIONS

Small business corporation

- **S Corporation --** A unique **government creation** that looks like a corporation, but is taxed like sole proprietorships and partnerships. Usually chosen by small businesses.
  - S corporations have shareholders, directors and employees, plus the benefit of **limited liability**.
  - Profits are taxed only as the **personal income** of the shareholder.
    - Limited to a maximum of **100** shareholders – may include individuals, certain trusts, estates but **not partnerships nor non resident foreign shareholders.**
    - S corps **can** only issue **common stock.**

Why choose an "S" Corp?

- An "S" Corp offers a single level of tax. This is referred to as a "pass through" entity.
- The corporation will generally **not pay** income tax, but rather the **profit or loss** and other **attributes** are included on the tax return(s) of the shareholders.
- S-Corporations can distribute money to shareholders as **distributions of profits**, rather than as salary.
  - As a result, the shareholders of the company do not have to pay Medicare or Social Security taxes on this distributed income.

S-corporation

Pros of S-corporation

- Owners (shareholders) don't have personal liability for the business's debts and liabilities.
- No corporate taxation and no double taxation: An S-corp is a pass-through entity, so the government taxes it much like a sole proprietorship or partnership.

Cons of S-corporation

- Like C-corporations, S-corporations are more expensive to create than both sole proprietorships and partnerships (requires registration with the state).
- There are more limits on issuing stock in S-corps vs. C-corps.
- You still need to comply with corporate formalities, like creating bylaws and holding board and shareholder meetings.

Difference between C Corp and S Corp

C Corporation

1. Are taxed on profits that the company makes.
2. Can be subject to having their income double taxed.
3. Can be owned by domestic people or foreigners
4. Other business entities, such as partnerships or other corporations, are also permitted to own shares of C-Corporations.
5. Unlimited number of shareholders.
6. More flexibility in terms of who owns a stake in the business and in issuing stock.
7. May issue all different types of stock, with different shareholders having different types of ownership interests.

S Corporation

1. Profits and losses pass through to individual shareholders/owners, who then declare the income or deduct the losses on their personal tax returns.
2. Can distribute money to shareholders as distributions of profits, rather than as salary.
3. More restrictions on ownership of S-Corporations – only local people
4. May issue just one category of stock and are not allowed to issue preferred stock.
5. Number of investors who can co-own an S-corporation is limited. Maximum 200 people.

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CO-OPERATIVE

- **Cooperatives --** Businesses owned and controlled by the people who use them– producers, consumers, or workers – its members with similar needs who pool their resources for mutual gain.

- *The founders may be private individuals or corporations, or foundations, of other legal entities. As well as giving members an equal say and share of the profits, co-operatives act together to build a better world through co-operation.*

- Worldwide, 750,000 co-ops serve 730 million members – 120 million in the U.S.

- Members democratically control the business by electing a board of directors that hires professional management.

Co-operative

+ Pros

- It's member-owned and controlled with member effort
- Decisions are made democratically by the members which provide a strong direction to the operations
- Profits are returned to members
- Allows communities and groups to take responsibility for their own needs

– Cons

- Might be complex to operate. Co-operatives need to invest time and money in supporting their democratic process, e.g. educating members about key issues.
- In order to run smoothly, co-operatives require unity, commitment and motivation from all its members.
- Access to capital might be challenging

- Cooperative Development Institute: Resources on Cooperative Development: http://goo.gl/x4fDE

Making the Decision

- Evaluate the pros and cons of the various legal forms before organizing a new venture
  - Consider
    - Your skills, access to capital, expenses and willingness to assume liability and degree of control you want to have.

Comparison

Type of entity	Limited Liability protections?	Tax Treatment	Level of Govt Requirements
Sole Proprietorship	No	At personal tax rate	Low
Partnership	For partners only	At personal tax rate	Low
Limited Liability Company	Yes	Can choose how you want to be taxed	Medium
C-Corporation	Yes	Must pay corporate taxes (but beware of double taxation on dividends)	High
S-Corporation	Yes	At personal tax rate	High
Coorperative	Yes	Single taxed	High

MERGERS and ACQUISITIONS

Corporate Expansion: Mergers and Acquisitions

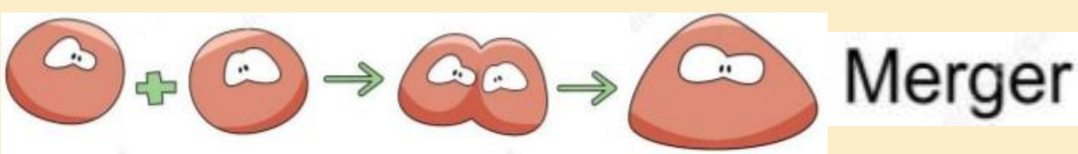
Mergers and acquisitions are transactions in which the ownership of companies, other business organizations, or their operating units are transferred or consolidated with other entities.

A company merger is a fusion of two companies

- **Merger --** The result of two firms joining to form one larger company.

Technically speaking, the two companies are of **similar size** for a **merger** to occur.
If one is **much larger** than the other, it is usually called an **acquisition**.

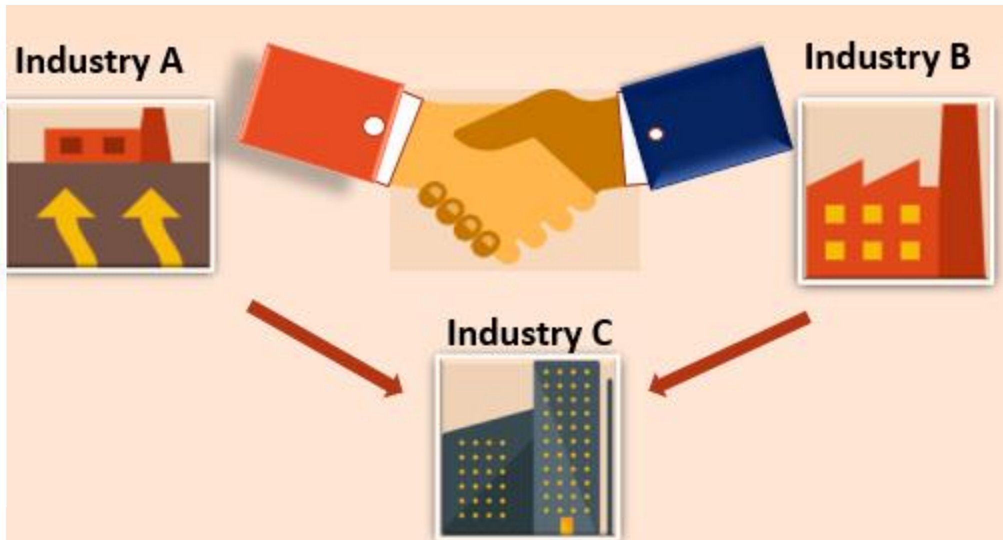
Acquisition -- One company's purchase of the property and obligations of another company.



Merger Examples

Coopers & Lybrand
+
Price Waterhouse

pwc



Sirius Satellite Radio
+
XM Satellite Radio

SiriusXM

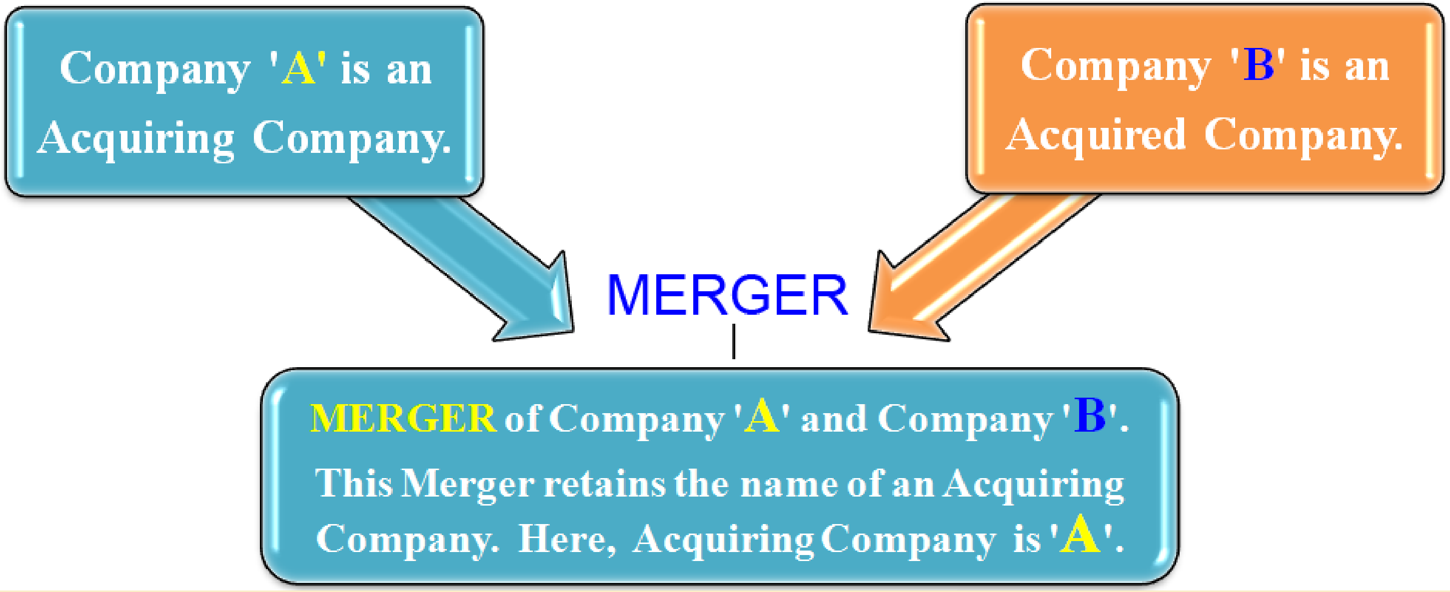
Exxon
+
Mobil

ExxonMobil

Astra
+
Zeneca Group

AstraZeneca

How to name the new company after merger



In many mergers, where the two companies have **strong brands**, the new entity **maintains their names**.

Coopers & Lybrand
+
Price Waterhouse

pwc

TYPES of MERGERS

Vertical Merger

- if a supplier and customer join in together , it is known as *vertical integration*. OR
- combines two companies that are involved in producing the same goods or services but at different stages of production

Horizontal Merger

- If the two merging companies were competitors, the fusion is known as a *horizontal integration*
- involve companies that offer the same products or services to the same kinds of customers.

Conglomerate Merger

combination of two or more corporations engaged in entirely different businesses that fall under one corporate group, usually involving a parent company and many subsidiaries.

A leading manufacturer of athletic shoes, merges with a soft drink firm.

Concentric Merger

Two companies are in **related** but not identical industries, the amalgamation is called a ***concentric merger***. In such cases, they can use the same skilled workforce and technologies to work in both industry segments, such as **leasing and banking**.

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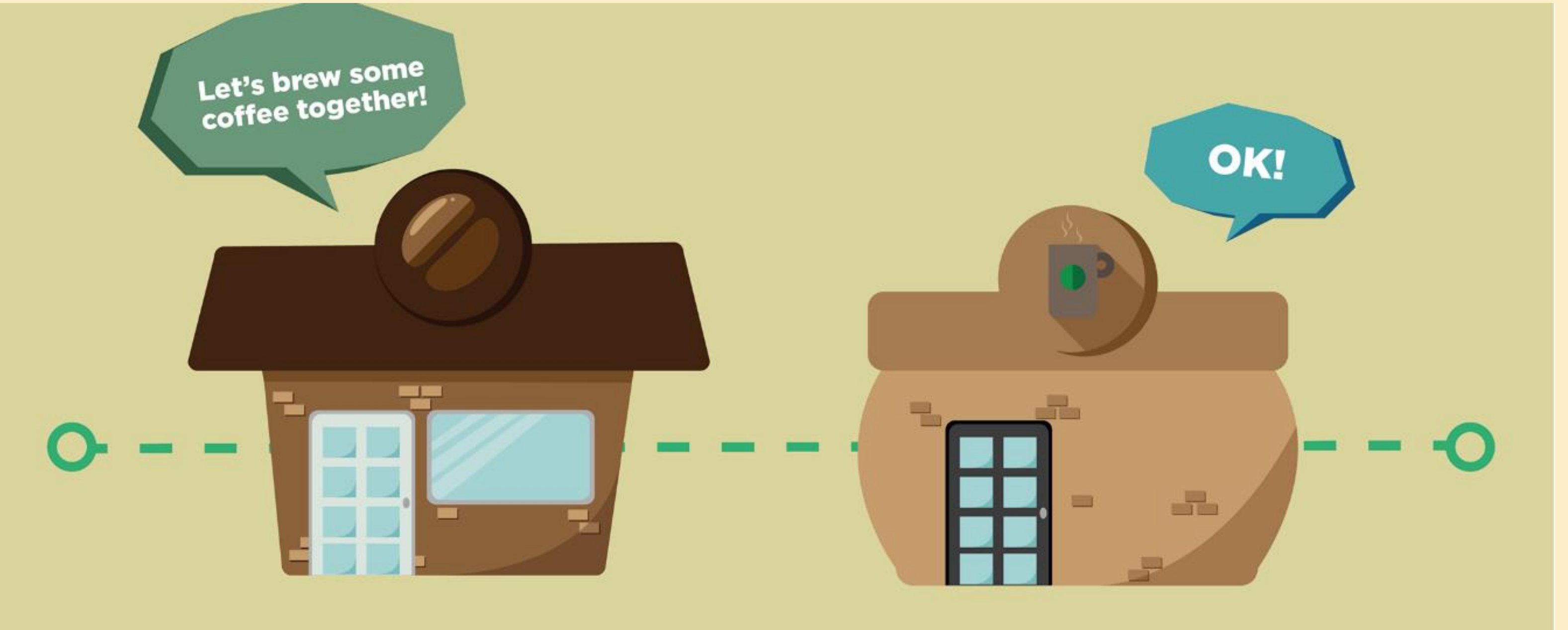
Types of Merger

Horizontal Merger

Recall: Merger of two companies who are direct competitors of one another. They serve the same market and sell the same product.



A horizontal merger is a combination of entities whose products or services directly compete in the same market.[1]

Horizontal Merger

Benefits	Drawbacks
• Cost Reduction. Having standardized offerings allows companies to operate at a large scale. • Quality Improvement. • Optimized Operations. • Specialized manpower.	• High risks of external forces • Higher customer acquisition cost (CAC) • Low bargaining power of customers. • Price discrimination.

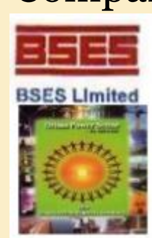
Examples of Horizontal Merger

- Brook Bond Lipton India
- Exxon-Mobile

  Exxon and Mobil - 2 distinct giants in oil industry

- Marriott – Starwood – two worldwide known hotel chains
- Vodafone – Idea

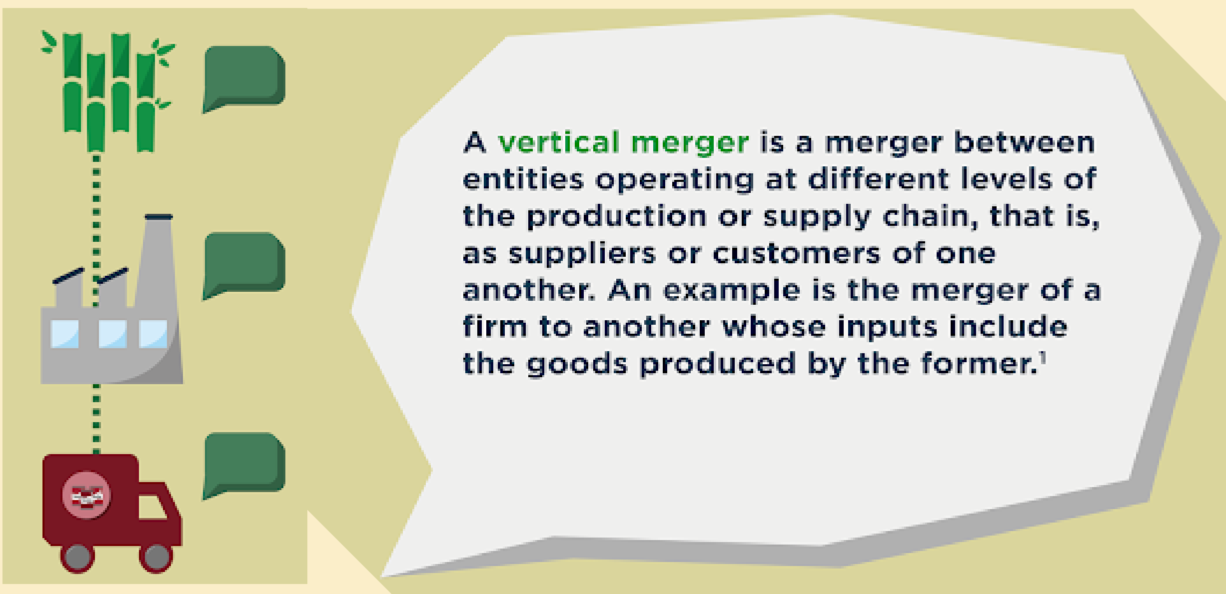
- JP Morgan and Chase Bank – Chase Manhattan Bank and JP Morgan
- Associated Cement Companies Ltd with Damodar Cement
- BSES Ltd with Orissa Power Supply Company



Types of Merger

Vertical Merger

Vertical Merger is a **merger** between companies in the **same industry**, but at **different stages** of production process.
In another words, a **vertical merger** occurs between companies where one buys or sells something from or to the other.
An **example** of a **vertical merger** is a car manufacturer purchasing a tire company.
Mergers between such companies occur in an effort to reduce production costs and increase efficiency for higher profits.



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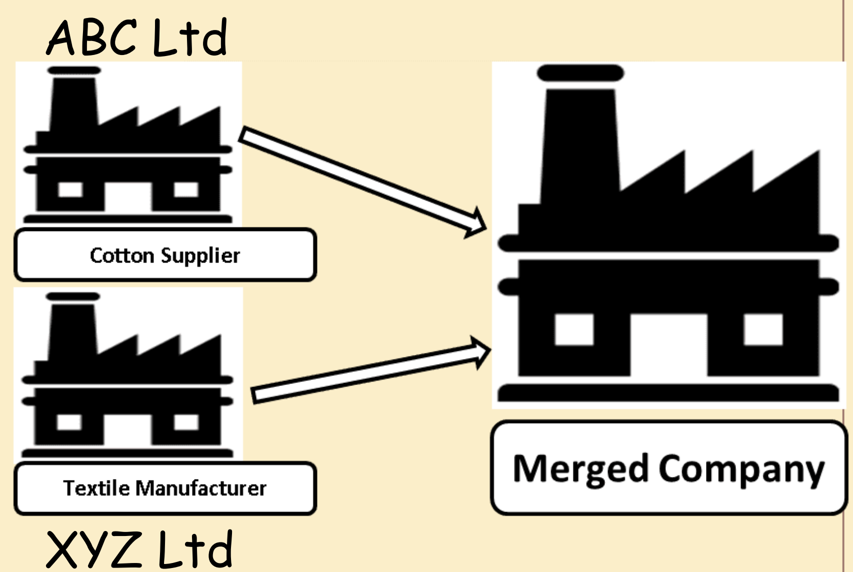
Vertical Merger

XYZ Ltd. is a textile manufacturer. ABC Ltd. is the supplier of cotton to XYZ Ltd. since many years. XYZ Ltd. and ABC Ltd. decide to merge their business. We can see that both the business entities are involved in the different stages of the production process. The reason for merging is to bring efficiency in operations by **cutting the extra costs** and **increase the profits of both the businesses.**

A vertical merger is becoming an integral part of many business strategies nowadays. The economic benefits of the vertical merger are driving many business houses to join hands with other businesses working at different levels of the supply chain for similar products and services. Going ahead, the vertical merger will become a common norm because of many economic benefits.



Examples of Vertical Merger

- Time Warner Incorporated a major cable operation and the Turner Corporation which produces CNN, TBS and other programming.
- Pixar-Disney Merger
- **Motorola** Mobility was sold to **Google** in 2012, and **acquired** by Lenovo in 2014.

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Pros and cons of vertical merger

Conglomerate Merger

Conglomerate merger involves a merger between two businesses that are not related to each other i.e. completely different industries or in different geographical areas.

Two types of conglomerate mergers:

- Pure conglomerate mergers involve firms with nothing in common.
- Mixed conglomerate mergers involve firms that are looking product
- extensions or market extensions

Example of conglomerate Merger

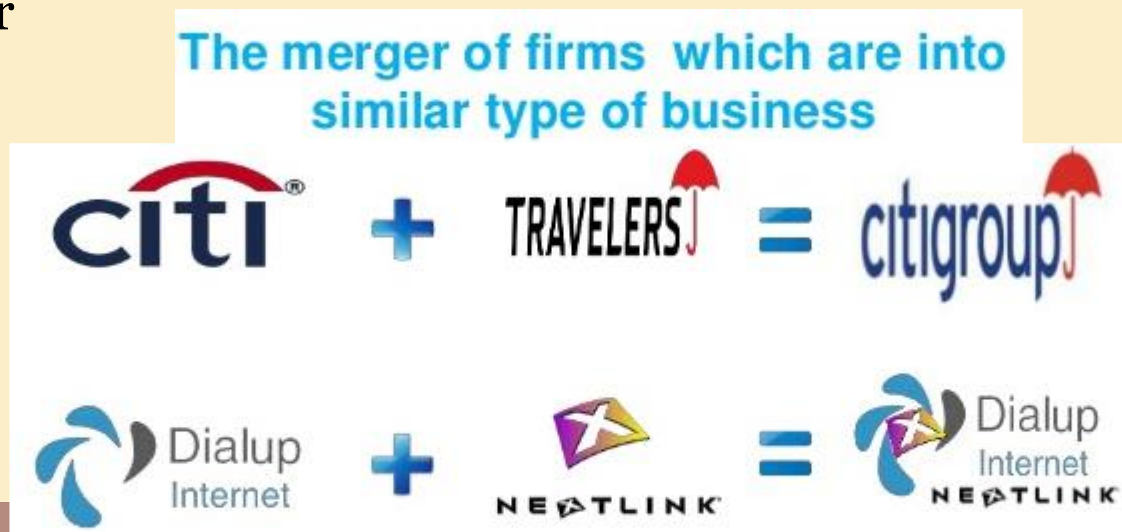
Walt Disney and the American Broadcasting Company.

Conglomerate

Advantages	Disadvantages
• Diversification of Business • Gain Synergies • Utilization of Excess Cash • Improves Customer Base • Utilization of Human Resources • Economies of Scale	• No Past Experience • Shift in Focus • Complication • Governance Issue

Concentric Merger

- A **concentric merger**, often called a congeneric **merger**, is the merging of firms that operate in the same industry but do not have a mutual relationship (such as a buyer-seller relationship).
- In simple terms it is the merger of companies dealing with **common expertise.**
- The expertise may be technological or managerial in nature.
- E.g. merger between motor cycle manufacturer and an automobile manufacturer



What is Reverse Merger?

A reverse merger is a merger in which a private company becomes a public company by acquiring it. Reverse merger saves a private company from the complicated process and expensive compliance of becoming a public company.

Advantages	Disadvantages
•The private company becomes a public company at a lesser cost and gets listed on the exchange without IPO. •Reverse merger helps in saving of taxes of private companies.	•Lawsuits for various reasons are very common during the reverse merger. •Reverse merger leads to reverse stock splits. This further leads to a reduction in the number of shares held by the shareholders.

FRANCHISE

- **A franchise** is an agreement or bargain whereby the owner of a trademark (franchisor), brand name and business logo, or copyright grants others (franchisees) license to use it in selling goods and services *in a given territory.*

- *Very common way of doing business.*

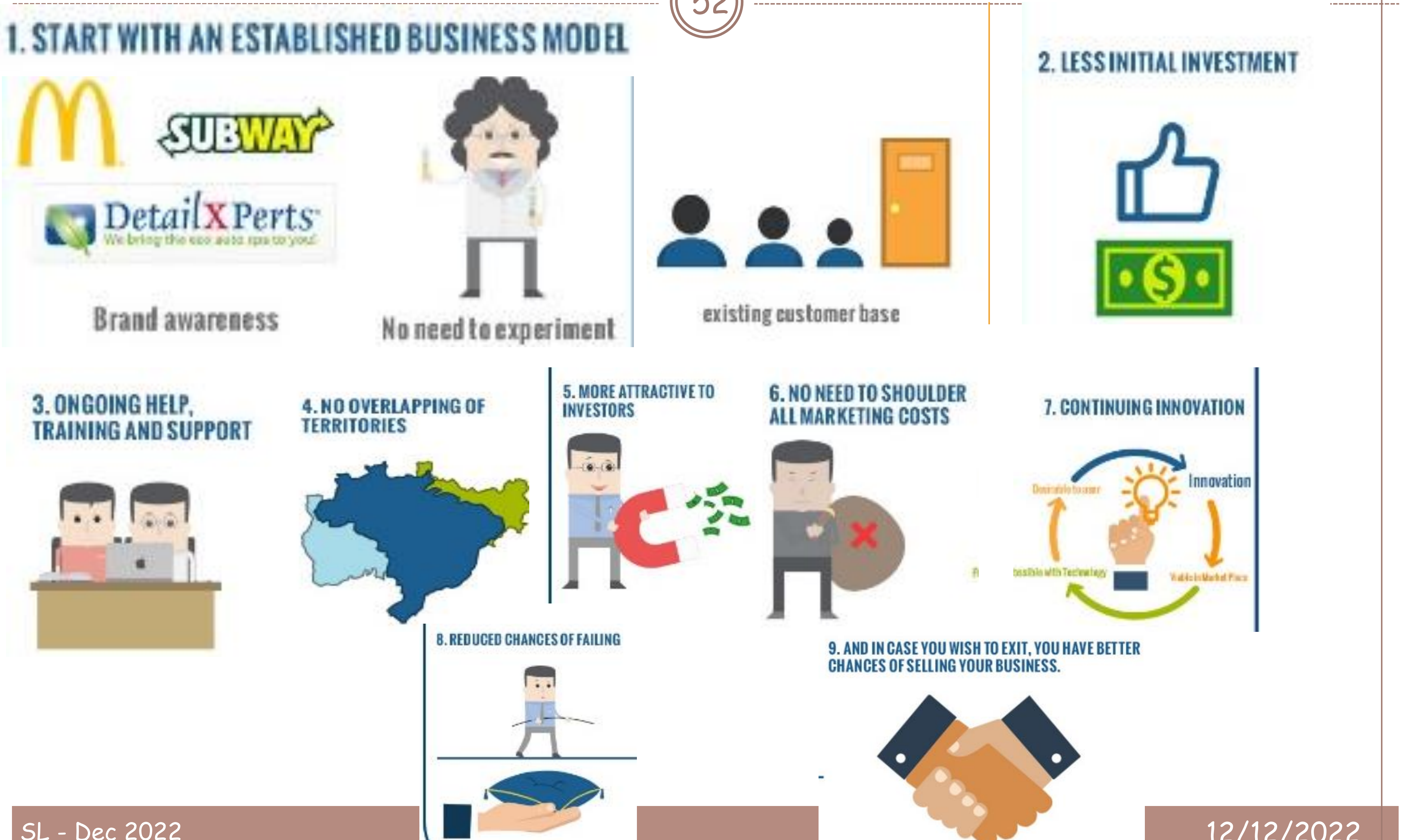
Franchisor / Franchiser
The person or company that grants the franchisee the right to do business under their trademark or tradename.

Franchisee
The person or company that gets the right from the franchisor to do business under the franchisor's trademark or tradename and benefits from it.

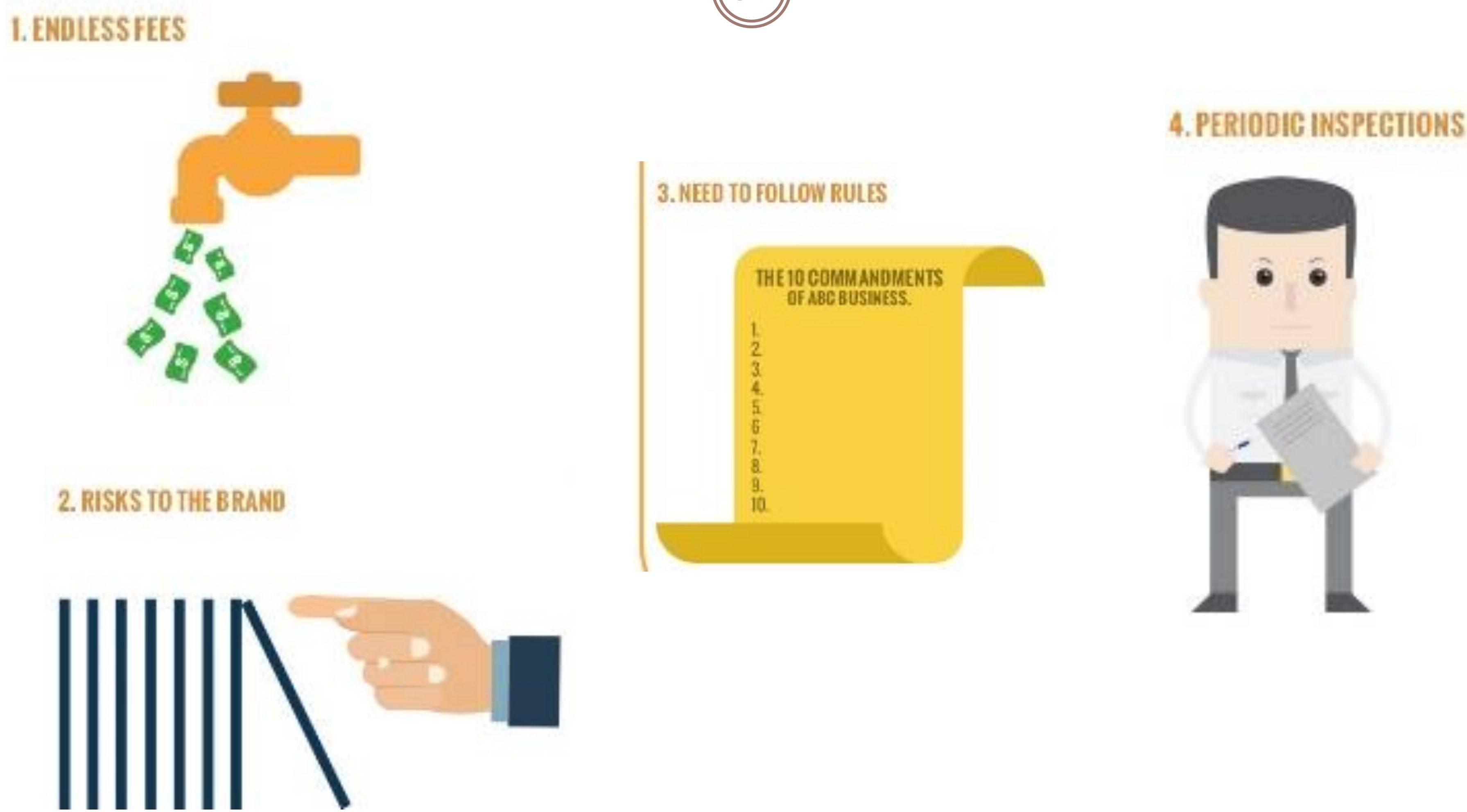
•World famous franchises – starbucks, Mc Donalds, KFC

Examples of well known franchises

Benefits of Being a Franchisee



Drawbacks of Being a Franchisee



Do's and Don'ts

Do:

- Explore your options.
- Search for a franchise that has a unique sales proposition.
- Look for a franchise that offers a lot of flexibility.
- Select a franchisor that takes customer satisfaction seriously.
- Select a franchisor that you can build a relationship with.

Don'ts:

- Forget that you belong to a system.
- Take comments and suggestions personally.
- Hesitate to ask for help.

Using Technology in Franchising

Franchisors often use technology to meet the needs of both their customers and their franchisees.

For example, U.S Web Corporation set up it Web site to streamline communication for its employees, customers, and vendors. It built a computer network to allow communication among its 50 franchisee, almost eliminating paperwork.

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E-COMMERCE in FRANCHISHING

- Most brick-and-mortar franchises have expanded to the Internet.

- Many franchisors prohibit franchisee-sponsored sites because conflicts can erupt.

"I have had enough."

- Sometimes "reverse royalties" are sent to franchisees who believe their sales were hurt by the franchisor's site.

- Other franchises are solely based online.

Diversity in Franchising
Women in Franchises

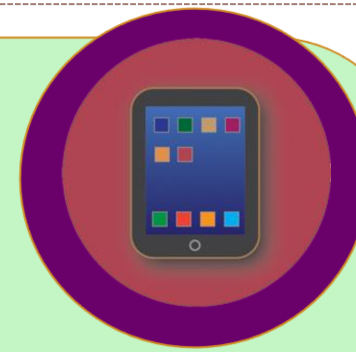
- Women own about half of U.S. companies, yet ownership of franchises is about 25%.
- Firms owned by women have grown at twice the rate of all companies.
- More women are becoming franchisors.
- Auntie Anne's and Jazzercise are owned by women.

JAZZERCISE

MINORITY-OWNED FRANCHISES

- MinorityFran is an initiative to build awareness of franchising opportunities within minority communities.
- Domino's Pizza launched a minority franchise recruitment program called Delivering the Dream.
- Over 20% of franchises are minority-owned.

FRANCHISE EXPANSION on FACEBOOK



- Many businesses use social media to communicate with potential investors and franchisees.
- Häagen-Dazs launched a simulation game called Ice Cream Boss on Facebook.
- The company hopes that players may move on to become franchisees of real Häagen-Dazs stores.

GLOBAL FRANCHISING

- Canada is the most popular target for U.S.-based franchises. China, South Africa, the Philippines and the Middle East are becoming popular despite high cost.
- Franchising is successful when the product is convenient, high quality, great service is included and the franchisee adapts to the region.
- International franchising goes both ways – some foreign franchises have come to the U.S.

WHAT to CHOOSE?

Picking Franchises that May Survive a Recession

- Focus on tried-and-true name brands.
- Stick to core goods and services.
- Be choosy about the site.
- Don't pinch pennies.
- Have a fallback choice.
- Don't assume the franchise will pay off.

Source: Richard Gibson, Wall Street Journal, www.wsj.com, accessed June 2011.