

ENT 2112 Homework 7

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All uncited quotes are from the textbook

1. When should your friend, who is considering launching a consulting firm to provide financial services to small businesses, think about the ethical climate she wants to establish in her venture?
 - Financial services are not the place to be if you want to skirt ethics. If she has to think about it at all, she shouldn't be giving financial advice.
2. Based on the information included in this chapter, in general, do entrepreneurs tend to overestimate or underestimate their knowledge of the laws that pertain to starting a new firm, and why?
 - They overestimate their knowledge because entrepreneurs are full of themselves and think they know everything. How else would they know that *their* idea is the "next big thing".
3. What are the prerequisites for building a strong ethical culture in a firm?
 - *"Pressure to compromise organizational standards.* This factor is an important warning sign of future workplace misconduct.
 - *Observed misconduct.* Misconduct is the most basic indicator of the state of integrity in an organization. To what extent do employees follow the rules and live out the core values of organization?
 - *Report observed misconduct.* This refers to whether employees report misconduct when they observe it, rather than remaining silent.
 - *Experience retaliation for reporting misconduct.* This refers to whether employees who report misconduct are retaliated against, such as by getting the silent treatment or being exposed to verbal harassment, demotions, undesirable assignments, or even violence.¹
4. What are some of the specific steps that can be taken in an entrepreneurial venture for the purpose of building a strong ethical culture?
 - Lead by example
 - Establish a code of conduct
 - Implement an ethics training program
 - Or, idk, don't hire people who have poor morals or ethics?
5. What is the purpose of a *code of conduct*?
 - "A **code of conduct** (or code of ethics) is a formal statement of an organization's values regarding certain ethical and social issues.² The advantage of having a code of conduct is that it provides specific guidance to entrepreneurs, managers, and employees regarding expectations of them in terms of ethical behavior."

6. What is the purpose of establishing and using an *ethics training program* in an entrepreneurial firm?
 - "**Ethics training programs** teach business ethics to help employees deal with ethical dilemmas and improve their overall ethical conduct. An **ethical dilemma** is a situation that involves doing something that is beneficial to oneself or the organization, but may be unethical."
7. What are some of the more important criteria to consider when selecting an attorney for a new firm?

TABLE 7.3 How to Select an Attorney

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1. Contact the local bar association and ask for a list of attorneys in your area who specialize in business start-ups.
 2. Interview several attorneys. Check references. Ask your prospective attorney whom he or she has guided through the start-up process before and talk to the attorney's clients. If an attorney is reluctant to give you the names of past or present clients, select another attorney.
 3. Select an attorney who is familiar with the start-up process. Make sure that the attorney is more than just a legal technician. Most entrepreneurs need an attorney who is patient and is willing to guide them through the start-up process.
 - 4. Select an attorney who can assist you in raising money for your venture. This is a challenging issue for most entrepreneurs, and help in this area can be invaluable.
 5. Make sure your attorney has a track record of completing work on time. It can be very frustrating to be prepared to move forward with a business venture, only to be stymied by delays on the part of an attorney.
 6. Talk about fees. If your attorney won't give you a good idea of what the start-up process will cost, keep looking.
 7. Trust your intuition. Select an attorney who you think understands your business and with whom you will be comfortable spending time and having open discussions about the dreams you have for your entrepreneurial venture.
 8. Learn as much about the process of starting a business yourself as possible. It will help you identify any problems that may exist or any aspect that may have been overlooked. Remember, it is your business start-up, not your attorney's. Stay in control.
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8. What is a founders' agreement and why is it important for a team of entrepreneurs to have one in place when launching a venture?
 - "If two or more people start a business, it is important that they have a founders' (or shareholders') agreement. A **founders' agreement** is a written document that deals with issues such as the relative split of the equity among the firm's founders, how individual founders will be compensated for the cash or the "sweat equity" they put into the firm, and how long the founders will have to remain with the firm for their shares to fully vest."
9. What is the purpose of a nondisclosure agreement and the purpose of a noncompete agreement?
 - "There are also two important written agreements that the majority of firms ask their employees to sign. A **nondisclosure agreement** binds an employee or another party (such as a supplier) to not disclose a company's trade secrets. A **noncompete agreement** prevents an individual from competing against a former employer for a specific period of time."
10. How can entrepreneurial ventures avoid legal disputes?
 - Meet all contractual obligations
 - Avoid undercapitalization
 - Get everything in writing
 - Set standards
11. What is mediation and how do entrepreneurs use it to resolve disputes?

- **Mediation** is a process in which an impartial third party (usually a professional mediator) helps those involved in a dispute reach an agreement.
12. At what point, during the process of starting a firm, does a business need to focus on the business licenses and permits that it needs, and why at that point?
- When they're in the planning stage. If they do 90% of the work then find out they need a permit they won't be able to get, then that really sucks for them.
13. Why is it important for a firm's founders to think carefully about the name they pick for their company?
- "A **fictitious business name permit** allows a business to legally operate under a fictitious name, like Gold Coast Sea Food or Red Rock Bakery. Selecting a name for a business and obtaining a fictitious business name permit if needed is an important task, not only to comply with the law but because a business's name is a critical part of its identity and its branding strategy. It is also one of the first things that people associate with a business."
14. Why isn't choosing a legal entity a one-time event?
- "As a business grows and matures, it is necessary to periodically review whether the current form of business organization remains appropriate."
15. What might trigger a firm's decision to change how it is legally organized?
- "As a business grows and matures, it is necessary to periodically review whether the current form of business organization remains appropriate."
16. What are the advantages and disadvantages of organizing a new firm as a sole proprietorship?

TABLE 7.6 Comparison of Forms of Business Ownership

| Factor | Sole Proprietorship | Partnership | | Corporation | | Limited Liability Company |
|-------------------------------------------|------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------|---------------------------------------------------------------------------|---------------------------------------------------------------------------------------------|
| | | General | Limited | C Corporation | S Corporation | |
| Number of owners allowed | 1 | Unlimited number of general partners allowed | Unlimited number of general and limited partners allowed | Unlimited | Up to 100 | Unlimited number of "members" allowed |
| Cost of setting up and maintaining | Low | Moderate | Moderate | High | High | High |
| Personal liability of owners | Unlimited | Unlimited for all partners | Unlimited for general partners; limited partners only to extent of investment | Limited to amount of investment | Limited to amount of investment | Limited to amount of investment |
| Continuity of business | Ends at death of owner | Death or withdrawal of one partner unless otherwise specified | Death or withdrawal of general partner | Perpetual | Perpetual | Typically limited to a fixed amount of time |
| ○ Taxation | Not a taxable entity; sole proprietor pays all taxes | Not a taxable entity; each partner pays taxes on his or her share of income and can deduct losses against other sources of income | Not a taxable entity; each partner pays taxes on his or her share of income and can deduct losses against other sources of income | Separate taxable entity | No tax at entity level; income/loss is passed through to the shareholders | No tax at entity level if properly structured; income/loss is passed through to the members |
| Management control | Sole proprietor is in full control | All partners share control equally, unless otherwise specified | Only general partners have control | Board of directors elected by the shareholders | Board of directors elected by the shareholders | Members share control or appoint managers |
| Method of raising capital | Must be raised by sole proprietor | Must be raised by general partners | Sale of limited partnerships, depending on terms of operating agreement | Sell shares of stock to the public | Sell shares of stock to the public | It's possible to sell interests, depending on the terms of the operating agreement |
| Liquidity of investment | Low | Low | Low | High, if publicly traded | Low | Low |
| Subject to double taxation | No | No | No | Yes | No | No |

17. Is a sole proprietorship a separate legal entity? Why or why not? What are the differences between a general partnership and a limited partnership?

- o "A sole proprietorship is not a separate legal entity. For tax purposes, the profit or loss of the business flows through to the owner's personal tax return document and the business ends at the owner's death or loss of interest in the business."

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18. What are the differences between a general partnership and a limited partnership?

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19. What are the major advantages and disadvantages of a C corporation?

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| Liquidity of investment | Low | Low | Low | High, if publicly traded | Low | Low |
| Subject to double taxation | No | No | No | Yes | No | No |

20. How is a C corporation subject to double taxation?

- o "A disadvantage of corporations is that they are subject to **double taxation**, which means

that a corporation is taxed on its net income and, when the same income is distributed to shareholders in the form of dividends, is taxed again on shareholders' personal income tax returns."