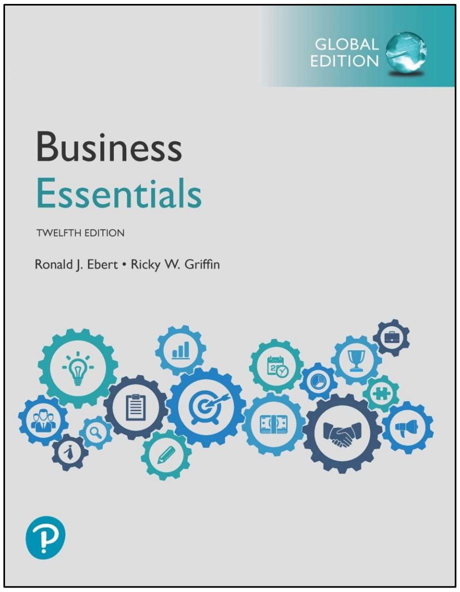
# Business Essentials

Twelfth Edition, Global Edition




## Chapter 3

Entrepreneurship, New Ventures, and Business Ownership

Pearson



If this PowerPoint presentation contains mathematical equations, you may need to check that your computer has the following installed:

1) MathType Plugin
2) Math Player (free versions available)
3) NVDA Reader (free versions available)

# Introduction

- **In this chapter, we examine**
  - converting a great business idea into a profitable enterprise
  - assessing the market potential for new and up-and-coming businesses
  - the business plan, reasons for success and failure
  - advantages and disadvantages of different kinds of ownership

Pearson 

## Learning Objectives (1 of 2)

1. **Define** small business, discuss its importance to the U.S. economy, and explain popular areas of small business.
2. **Explain** entrepreneurship and describe some key characteristics of entrepreneurial personalities and activities.
3. **Describe** distinctive competence, the business plan, and the start-up decisions made by small businesses and identify sources of financial aid available to such enterprises.

Pearson 

## Learning Objectives (2 of 2)

4. **Discuss** the trends in small business start-ups and identify the main reasons for success and failure among small businesses.
5. **Explain** sole proprietorships, partnerships, and cooperatives and discuss the advantages and disadvantages of each.
6. **Describe** corporations, discuss their advantages and disadvantages, and identify different kinds of corporations; explain the basic issues involved in managing a corporation and discuss special issues related to corporate ownership.

Pearson 

## What Is a "Small" Business?

- **Small business**
  - one that is independent (not part of a larger business) and that has relatively little influence in its market
- **Small Business Administration (SBA)**
  - government agency charged with assisting small businesses



The U.S. Department of Commerce considers a business "small" if it has fewer than 500 employees.

The U.S. Small Business Administration (SBA) regards some companies with as many as 1,500 employees as small, but only if the business has relatively low annual revenues.

Because strict numerical terms sometimes lead to contradictory classifications, we will consider a small business to be one that is independent (that is, not part of a larger business) and that has relatively little influence in its market.

# The Importance of Small Business in the United States (1 of 2)

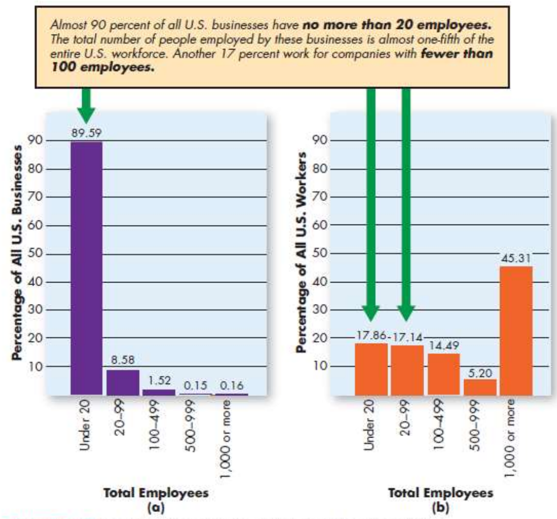



**FIGURE 3.1** The Pervasiveness of Small Business in the United States
*Source:* Data from www.census.gov/

Pearson



As Figure 3.1 shows, most U.S. businesses employ fewer than 100 people, and most U.S. workers are employed by small business. Moreover, this same pattern exists across most free market economies.

# The Importance of Small Business in the United States (2 of 2)

- Job creation
- Innovation
- Contributions to big business

## Job Creation

- Small businesses have accounted for about 40 percent of all new jobs in high-technology sectors of the economy
- Small businesses are generally the first to hire in times of economic recovery

Pearson

# Popular Areas of Small-Business Enterprise

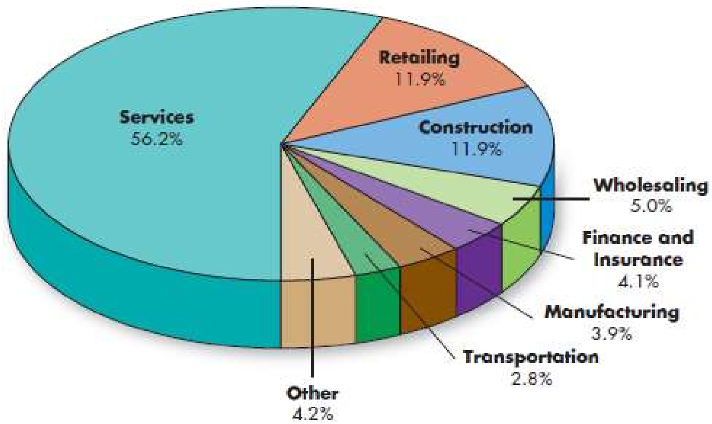



**FIGURE 3.2** Small Business by Industry
*Source:* www.census.gov/

Pearson



Figure 3.2 shows the distribution of all U.S. businesses employing fewer than 20 people across industry groups.

# Entrepreneurship

- **Entrepreneur**
  - businessperson who accepts both the risks and the opportunities involved in creating and operating a new business venture
- **Entrepreneurship**
  - the process of seeking business opportunities under conditions of risk

Pearson



Many entrepreneurs seek to launch a new business with the goal of independence—independence from working for someone else coupled with some reasonable degree of financial security.

Such entrepreneurs want to achieve a safe and secure financial future for themselves and their families but do not aspire to grow their business beyond their capacity to run it.

## Entrepreneurial Characteristics

- Resourcefulness
- Concern for good, personal customer relations
- Strong desire to be their own bosses
- Deal with uncertainty and risk

Pearson



Entrepreneurs share certain characteristic such as resourcefulness and a concern for good, often personal, customer relations.

Most of them also have a strong desire to be their own bosses.

## Understanding Distinctive Competencies

- **Established Market**
  - one in which many firms compete according to relatively well-defined criteria
- **Niche**
  - a segment of a market that is not currently being exploited

Pearson



An established market is one in which many firms compete according to relatively well-defined criteria.

A niche is simply a segment of a market that is not currently being exploited. In general, small entrepreneurial businesses are better at discovering these niches than are larger organizations.

## First-Mover Advantages

- **First-mover advantage**
  - is any advantage that comes to a firm because it exploits an opportunity before any other firm does



A first-mover advantage is any advantage that comes to a firm because it exploits an opportunity before any other firm does.

Sometimes large firms discover niches within existing markets or new markets at just about the same time small entrepreneurial firms do, but are not able to move as quickly as small companies to take advantage of these opportunities.

Many of the “app” developers for smartphones are exploiting first-mover advantage.

## Starting and Operating a New Business

- **Business plan**
  - Document in which the entrepreneur describes her or his business strategy for the new venture and demonstrates how it will be implemented



A real benefit of a business plan is the fact that in the act of preparing it, the would-be entrepreneur must develop the business idea on paper and firm up his or her thinking about how to launch it before investing time and money in it.

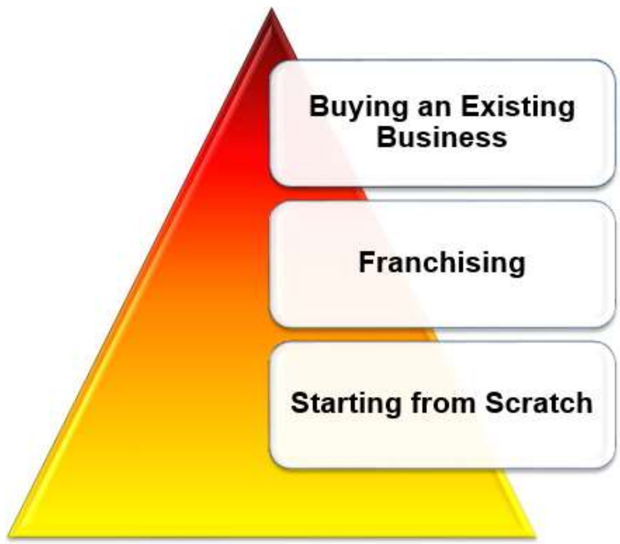
## Crafting a Business Plan

- Setting Goals and Objectives
- Sales Forecasting
- Financial Planning



The entrepreneur must demonstrate an understanding of the current market, of the strengths and weaknesses of existing firms, and of the means by which the new venture will compete.

# Starting the Small Business



## Starting a Small Business

- **Franchise**
  - arrangement in which a buyer (franchisee) purchases the right to sell the good or service of the seller (franchiser)

Pearson



Most McDonald's, Subway, 7 Eleven, RE/Max, Ramada, and Dunkin' Donuts outlets are franchises operating under licenses issued by parent companies to local owners. A franchise agreement involves two parties, a franchisee (the local owner) and a franchiser (the parent company).

## Franchising

- **Advantages**
  - Proven business opportunity
  - Access to management expertise
- **Disadvantages**
  - Start-up costs
  - Ongoing payments
  - Management rules and restrictions

## Starting from Scratch

- 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?

Pearson

## Financing a Small Business (1 of 2)

- Personal resources
- Loans from family and friends
- Bank loans
- Venture capital companies
- Small-Business Investment Companies (SBICs)
- Minority Enterprise Small-Business Investment Companies (MESBICs)
- SBA financial programs

## Financing a Small Business (2 of 2)

- **Venture Capital Company**
  - group of small investors who invest money in companies with rapid growth potential
- **Small-Business Investment Company (SBIC)**
  - government-regulated investment company that borrows money from the SBA to invest in or lend to a small business

Pearson 

Venture capital companies are groups of small investors seeking to make profits on companies with rapid growth potential. Most of these firms do not lend money. They invest it, supplying capital in return for partial ownership (like stocks, discussed later in this chapter).

Small business investment companies (SBICs) also invest in companies with potential for rapid growth. They are federally licensed to borrow money from the SBA and to invest it in or lend it to small businesses, and they are themselves investments for their shareholders. Past beneficiaries of SBIC capital include Apple Computer, Intel, and FedEx.

## Trends in Small-Business Start-Ups (1 of 2)

- **Emergence of E-Commerce**
  - The Internet provides fundamentally new ways of doing business
- **Crossovers from Big Business**
  - More businesses are being started by people who have opted to leave big corporations and put their experience to work for themselves
- **Opportunities for Minorities and Women**
  - More small businesses are also being started by minorities and women

Pearson 

Because the Internet provides fundamentally new ways of doing business, savvy entrepreneurs have created and expanded new businesses faster and easier than ever before.

More businesses are being started by people who have opted to leave big corporations and put their experience to work for themselves.

More small businesses are also being started by minorities and women. The number of businesses owned by African Americans increased by 60 percent during the most recent five-year period for which data are available and now totals about 2 million. The number of Hispanic-owned businesses has grown 44 percent and now totals about 2.25 million. Ownership among Asians has increased 1 percent and among Pacific Islanders 35 percent.

# Emergence of E-commerce

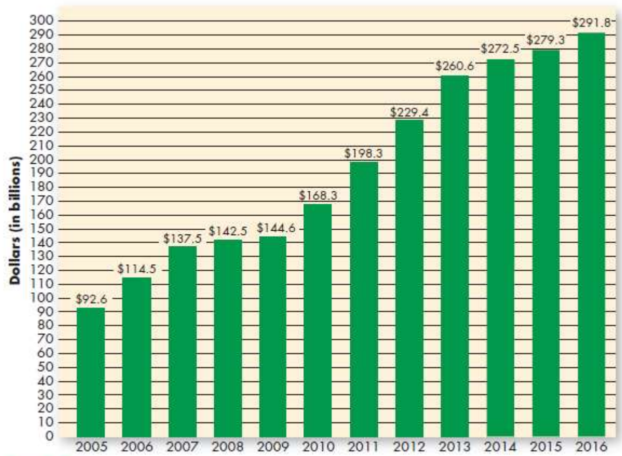



**FIGURE 3.3** Growth of Online Retail Spending
*Source:* http://www.census.gov/retail/

Pearson

## Reasons Women Give for Starting Businesses


**FIGURE 3.4** Reasons Women Give for Starting Businesses



Almost 8 million businesses are now owned by women, and they generate a combined $200 trillion in revenue a year and employ about 13 million workers. Figure 3.4 shows some of the reasons women cite for starting their own businesses.


Many entrepreneurs are also finding new opportunities in foreign markets.

More people are encouraged to test their skills as entrepreneurs because the small business failure rate has declined. During the 1960s and 1970s, less than half of all new start-ups survived more than 18 months; only one in five lasted 10 years. Now, however, 44 percent can expect to survive for at least four years.

## Reasons for Failure

1. Managerial incompetence or inexperience
2. Neglect
3. Weak control systems
4. Insufficient capital

Pearson



1 ***Managerial incompetence or inexperience****.* Some entrepreneurs put too much faith in common sense, overestimate their own managerial skills, or believe that hard work alone ensures success.
2 ***Neglect****.* Some entrepreneurs try to launch ventures in their spare time, and others devote only limited time to new businesses.
But starting a small business demands an overwhelming time commitment.
3 ***Weak control systems****.* Effective control systems keep a business on track and alert managers to potential trouble. If your control systems don't signal impending problems, you may be in serious trouble before you spot more obvious difficulties.
4 ***Insufficient capital****.* Some entrepreneurs are overly optimistic about how soon they'll start earning profits. In most cases, it takes months or even years.

## Reasons for Success

1. Hard work, drive, and dedication
2. Market demand for the products or services being provided
3. Managerial competence
4. Luck



1 ***Hard work, drive, and dedication****.* Small-business owners must be committed to succeeding and willing to spend the time and effort to make it happen.
2 ***Market demand for the products or services being provided****.* Careful analysis of market conditions can help small-business owners assess the probable reception of their products.
3 ***Managerial competence****.* Successful owners may acquire competence through training or experience or by drawing on the expertise of others.
4 ***Luck****.*

## Noncorporate Business Ownership

- **Sole Proprietorship**
  - business owned and usually operated by one person who is responsible for all of its debts
- **General Partnership**
  - business with two or more owners who share in both the operation of the firm and the financial responsibility for its debts

Pearson



The sole proprietorship is owned and usually operated by one person. About 74 percent of all U.S. businesses are sole proprietorships; however, they account for only about 4 percent of total business revenues.

The most common type of partnership, the general partnership, is similar to a sole proprietorship but is owned by more than one person. Partners may invest equal or unequal sums of money. In most cases, partners share the profits equally or in proportion to their investment.

# Sole Proprietorship

- **Advantages**
  - Freedom
  - Simple to form
  - Low start-up costs
  - Tax benefits
- **Disadvantages**
  - Unlimited liability
  - Limited resources
  - Limited fundraising capability
  - Lack of continuity

# 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 partners
  - Disagreements among partners
  - Lack of continuity

# Comparative Summary: Three Forms of Business

**Table 3.1 Comparative Summary: Three Forms of Business Ownership**

| Business Form | Liability | Continuity | Management | Sources of Investment |
|---|---|---|---|---|
| Proprietorship | Personal, unlimited | Ends with death or decision of owner | Personal, unrestricted | Personal |
| General Partnership | Personal, unlimited | Ends with death or decision of any partner | Unrestricted or depends on partnership agreement | Personal by partner(s) |
| Corporation | Capital invested | As stated in charter, perpetual or for specified period of years | Under control of board of directors, which is selected by stockholders | Purchase of stock |

Pearson 

## Alternatives to General Partnerships

- **Limited Partnership**
  - Allows for limited partners who invest money but are liable for debts only to the extent of their investments
  - General (or active) partners run the business
- **Master Limited Partnership**
  - Master partner has majority ownership and runs the business; minority partners have no management voice

Pearson 

**Limited Partnership**

- Allows for limited partners who invest money but are liable for debts only to the extent of their investments.
- General (or active) partner (or partners) runs the business.

**Master Limited Partnership**

- Organization sells shares (partnership interests) to investors on public exchange; investors paid back from profits.
- Master partner has majority ownership and runs the business; minority partners have no management voice.

## Cooperatives

- Combine the freedom of sole proprietorships with the financial power of corporations
- Groups of sole proprietorships or partnerships agree to work together for their common benefit

# Proportions of U.S. Firms in Terms of Organization Type and Sales Revenue

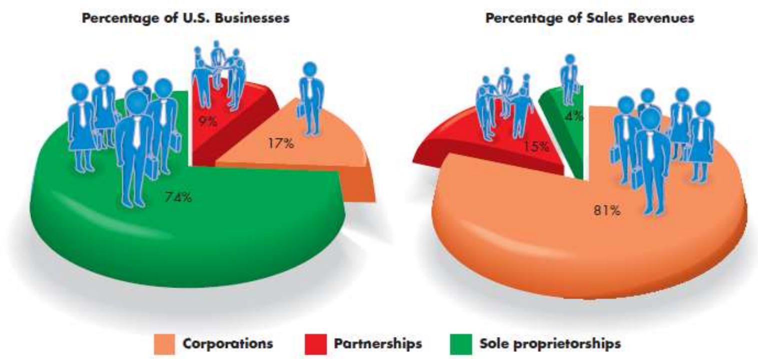



**FIGURE 3.5** Proportions of U.S. Firms in Terms of Organization Type and Sales Revenue
*Sources:* http://www.census.gov/

## The Corporate Entity

- **Corporation**
  - business that is legally considered an entity separate from its owners and is liable for its own debts; owners' liability extends to the limits of their investments

Pearson



When you think of corporations, you probably think of giant operations such as General Motors and IBM. In reality, however, your corner newsstand has as much right to incorporate as a giant automaker. A newsstand and GM would share the characteristics of all corporations: legal status as separate entities, property rights and obligations, and indefinite life spans.

## Corporations

- **Advantages**
  - Limited liability
  - Continuity
  - Stronger fundraising capability
- **Disadvantages**
  - Can be taken over against the will of its management
  - Double taxation of profits
  - Complicated and expensive to form

Pearson

# Types of Corporations (1 of 4)

**Table 3.2 Types of Corporations**

| Type | Distinguishing Features | Examples |
|---|---|---|
| Closely Held | Stock held by only a few people<br>Subject to corporate taxation | Blue Cross/Blue Shield<br>MasterCard<br>Primestar |
| Publicly Held | Stock widely held among many investors<br>Subject to corporate taxation | Apple<br>Starbucks<br>Texas Instruments |
| Subchapter S | Organized much like a closely held corporation<br>Subject to additional regulation<br>Subject to partnership taxation | Minglewood Associates<br>Entech Pest Systems<br>Frontier Bank |
| Limited Liability | Organized much like a publicly held corporation<br>Subject to additional regulation<br>Subject to partnership taxation | Pacific Northwest Associates<br>Global Ground Support<br>Ritz Carlton |
| Professional | Subject to partnership taxation<br>Limited business liability<br>Unlimited professional liability | Norman Hui, DDS & Associates<br>B & H Engineering<br>Anderson, McCoy & Oria |
| Multinational | Spans national boundaries<br>Subject to regulation in multiple countries | Toyota<br>Nestlé<br>General Electric |

Pearson

## Types of Corporations (2 of 4)

- **Closely Held (or Private) Corporation**
  - a corporation whose stock is held by only a few people and is not available for sale to the general public
- **Publicly Held (or Public) Corporation**
  - A corporation whose stock is widely held and available for sale to the general public
- **S Corporation**
  - a hybrid of a closely held corporation and a partnership, organized and operated like a corporation but treated as a partnership for tax purposes

Pearson



The most common form of U.S. corporation is the closely held (or private) corporation**.** Stock is held by only a few people and is not available for sale to the public. The controlling group of stockholders may be a family, a management group, or even the firm's employees. Most smaller corporations fit this profile.

When shares are publicly issued, the firm becomes a publicly held (or public) corporation**.** Stock is widely held and available for sale to the public. Many large businesses are of this type.

The S corporation (more fully called the *Subchapter S corporation*) is a hybrid of a closely held corporation and a partnership. It is organized and operated like a corporation, but it is treated like a partnership for tax purposes.

## Types of Corporations (3 of 4)

- **Limited Liability Corporation (LLC)**
  - hybrid of a publicly held corporation and a partnership in which owners are taxed as partners but enjoy the benefits of limited liability
- **Professional Corporation**
  - form of ownership allowing professionals to take advantage of corporate benefits while granting them limited business liability and unlimited professional liability

Pearson



Another hybrid is the limited liability corporation (LLC). Owners are taxed like partners, each paying personal taxes only. However, they also enjoy the benefits of limited liability accorded to publicly held corporations.

Professional corporations are most likely composed of doctors, lawyers, accountants, or other professionals. Although the corporate structure protects from unlimited financial liability, members are not immune from unlimited liability. Professional negligence by a member can entail personal liability on the individual's part.

## Types of Corporations (4 of 4)

- **Multinational (or Transnational) Corporation**
  - form of corporation spanning national boundaries

Pearson



As the term implies, the **multinational** (or **transnational**) **corporation** spans national boundaries. Stock may be traded on the exchanges of several countries, and managers are likely to be of different nationalities.

## Managing a Corporation

- **Corporate Governance**
  - roles of shareholders, directors, and other managers in corporate decision making and accountability

Pearson



Once the corporate entity comes into existence, it must be managed by people who understand the principles of corporate governance, the roles of shareholders, directors, and other managers in corporate decision making and accountability.

## Corporate Governance

- **Stockholder (or Shareholder)**
  - owner of shares of stock in a corporation
- **Board of Directors**
  - governing body of a corporation that reports to its shareholders and delegates power to run its day-to-day operations while remaining responsible for sustaining its assets
- **Officers**
  - top management team of a corporation



Corporate governance is established by the firm’s bylaws and usually involves three distinct bodies.

**Stockholders** (or **shareholders**) are the owners of a corporation, investors who buy ownership shares in the form of stock. The *board of directors* is a group elected by stockholders to oversee corporate management.
Corporate *officers* are top managers hired by the board to run the corporation on a day-to-day basis.

Although board members oversee operations, most do not participate in day-to-day management. Rather, they hire a team of managers to run the firm.

This team, called officers, is usually headed by the firm’s chief executive officer (CEO), who is responsible for overall performance. Other officers typically include a *president*, who is responsible for internal management, and *vice-presidents*, who oversee various functional areas such as marketing and operations.

## Special Issues in Corporate Ownership

- Joint Ventures and Strategic Alliances
- Employee Stock Ownership Plans
- Institutional Ownership
- Mergers, Acquisitions, Divestitures, and Spin-Offs

Pearson 

**Joint Venture –** strategic alliance in which the collaboration involves joint ownership of the new venture.
**Employee Stock Ownership Plan (ESOP) –** arrangement in which a corporation holds its own stock in trust for its employees, who gradually receive ownership of the stock and control its voting rights.
**Institutional Investor –** large investor such as a mutual fund or a pension fund that purchases large blocks of corporate stock.
**Merger –** the union of two corporations to form a new corporation.
**Acquisition –** the purchase of one company by another.
**Divestiture –** strategy whereby a firm sells one or more of its business units.
**Spin-Off –** strategy of setting up one or more corporate units as new, independent corporations.

## Applying What You've Learned (1 of 2)

1. **Define** small business, discuss its importance to the U.S. economy, and explain popular areas of small business.
2. **Explain** entrepreneurship and describe some key characteristics of entrepreneurial personalities and activities.
3. **Describe** distinctive competence, the business plan, and the start-up decisions made by small businesses and identify sources of financial aid available to such enterprises.

Pearson 

# Applying What You've Learned (2 of 2)

4. **Discuss** the trends in small business start-ups and identify the main reasons for success and failure among small businesses.
5. **Explain** sole proprietorships, partnerships, and cooperatives and discuss the advantages and disadvantages of each.
6. **Describe** corporations, discuss their advantages and disadvantages, and identify different kinds of corporations; explain the basic issues involved in managing a corporation and discuss special issues related to corporate ownership.

# Copyright

This work is provided solely for the use of instructors in teaching their courses and assessing student learning. Dissemination or sale of any part of this work (including on the World Wide Web) will destroy the integrity of the work and is not permitted. The work and materials from it should never be made available to students except by instructors using the accompanying text in their classes. All recipients of this work are expected to abide by these restrictions and to honor the intended pedagogical purposes and the needs of other instructors who rely on these materials.

Pearson