## Chapter Summary: Key Concepts

### Most Businesses are Small Businesses

**Small business**
A vital component of our economy, small businesses account for approximately 98% of U.S. firms. A small business is generally defined as an independent business having fewer than 500 employees. However, the size can vary according to the industry.

**Typical ventures**
Small businesses in America operate in nearly all industries, but tend to be concentrated in the retail, wholesale, construction, agriculture, and services sectors.

**Home-based businesses**
Half of all small businesses are home based due to access to the internet and the availability of communication devices.

### Contributions of Small Business to the Economy

**Creating new jobs**
Small businesses create approximately three out of four new jobs in the U.S. economy as opposed to larger firms. The majority of new job growth is among firms that provide services instead of goods. They also hire those who traditionally have had a difficult time finding work, such as women returning to the workforce.

**Creating new industries**
Small businesses give business people the opportunity to develop new ideas, some of which become entirely new industries. Many of today’s largest and most successful firms began as a small business. Small businesses also provide needed services to a larger corporate community.

**Innovation**
In a typical year, small firms will develop twice as many product innovations per employee, and produce 13 times more patents per employee than larger firms.

### Why Small Businesses Fail

**Management shortcomings**
These include lack of people skills, inadequate knowledge of finance, inability to track inventory or sales, poor assessment of competition, and a lack of time to do everything required.
First-time business owners assume that their firm will generate enough funds from their initial sales to finance continuing operations. However, most don’t turn a profit for months or even years due to start-up costs.

Unlike large-business who hire specialists to help the firm comply with government regulation, small-businesses have a limited staff.

Every business needs a plan in order to succeed. A business plan is a written document that provides an orderly statement of a company’s goals, the methods by which it will achieve these goals, and the standards by which it will measure its achievements.

- An executive summary and an introduction
- Financial and marketing sections
- The company’s mission and visions
- An outline of what makes the company unique
- The customers and the competition
- Financial evaluation of the industry and market conditions
- An assessment of the risks

The Small Business Administration (SBA) is a federal government agency concerned with helping small U.S. firms by providing advice, training, and securing government contracts. While not a provider of loans, the SBA guarantees small-business loans made by private lenders.

Low cost shared business facilities available to small start-up ventures developed by community agencies.

Money invested in a small business by another business or a group of individuals in exchange for an ownership share.

About 40% of U. S. businesses, more than 10 million firms, are owned by women. Many women leave large corporations when they feel blocked from opportunities for advancement or seek self-employment as a method to spend more time with family.
### Minority-owned Businesses

The growth in the number of businesses owned by African-Americans, Hispanics, and Asian-Americans has far outpaced the growth in the number of U.S. businesses overall, particularly in the services and retail industries.

### Franchising

#### Franchising

A contractual business arrangement between a manufacturer or another supplier and a dealer such as a restaurant or a retailer. Franchised businesses account for nearly 50% of retail sales.

#### Franchising agreements

Two principles in a franchising agreement are the franchisee, the individual or firm purchasing the franchise, and the franchisor, the firm whose products are sold by the franchisee.

#### Benefits to franchising

Franchising allows the franchisor to expand the business more rapidly, while the franchisee can take advantage of name recognition, an established management system, and a prior performance record.

#### Problems in franchising

Franchise fees and future payments are costly to franchisees. They may give up some independence under the franchise contract, and the entire franchise can be adversely affected by bad performance at one franchise unit.

### Legal Structures of Business Ownership

#### Sole proprietorship

Ownership of an organization by a single individual, considered the simplest and most common form of business. Common in industries such as repair shops, small retail stores, and service providers. Advantages include ease to dissolve and management flexibility. Disadvantages include personal liability, limited financial resources, and a lack of long-term continuity.

#### Partnership

An association of two or more persons who operate a business as co-owners by voluntary agreement. Advantages include ease of formation and greater financial capability. Disadvantages include unlimited liability, difficulty dissolving, and personal conflicts.

#### Corporation

A legal organization with assets and liabilities separate from those of its owner(s). Advantages include limited liability and expanded financial capabilities. A major disadvantage is double taxation.
Alternative Options for Ownership

Employee-owned corporations: A corporation in which workers buy shares of stock in the company that employs them, often through an employee stock ownership plan (ESOP’s).

Family-owned business: Considered the backbone of American business. These firms come in a variety of sizes and legal structures.

Not-for-profit corporations: Organizations whose goals do not include pursuing a profit. About 1.5 million not-for-profits operate in the United States in sectors such as museums, libraries, and hospitals.

Public and Collective Ownership of Business

Public ownership: The ownership and operation of an organization by a government unit or agency.

Collective (cooperative) ownership: A form of ownership where owners join forces to operate all or part of the activities in their firm or industry. Often referred to as a co-op.

Organizing a Corporation

Types of corporations: A firm is considered a domestic corporation in the state where it is incorporated, while foreign corporations are those who do business in one state while being incorporated in another. Alien corporations operate in the United States but are incorporated in another country.

Where and how businesses incorporate: Proximity to customers and access to a good labor pool are reasons for choosing a location. Although U.S. firms can incorporate in any state, some states such as Delaware are considered easier to incorporate in. States grant a corporate charter, which formally establishes a corporation.

Corporate management: Corporations generally have up to five levels of management: stock holders, board of directors, top managers, middle managers, and supervisory managers.

When Businesses Join Forces

Mergers: Two or more firms that combine to form one company. A vertical merger combines firms operating at different levels of production. A horizontal merger joins firms in the same industry, while a conglomerate merger combines unrelated firms.
Acquisitions
One firm purchases the property and assumes the obligations of another, or when one firm buys a division or subsidiary from another firm.

Joint venture
A partnership between companies formed for a specific undertaking.

Business Vocabulary

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Application of Vocabulary

Select the term from the list above that best completes the statements below. Write that term in the space provided.

1. A(n) _________________ occurs when one company buys the assets and assumes the liabilities of another firm.

2. _________________ are small-business loans often used to buy equipment or operate a business.

3. The purchaser of a franchise is known as the _________________.

4. _________________ are companies that sell franchises to independent business people.
5. Under the company form known as a(n) ____________________, the firm is governed under an operating agreement resembling a partnership, except that each partner’s liability for the actions of the other owners is limited.

6. A corporation that operates in the state in which it was chartered is considered a ________________ in that state.

7. ________________ is a type of business ownership in which workers buy shares of stock in the company that employs them.

8. A(n) ________________ is merger between firms whose businesses are unrelated.

9. The ________________, operated from the residence of the business owner, is a widely used and low cost option for new firms.

10. The __________________ is the principal federal government agency that aids, counsels, and assists small businesses.

11. ________________ are shares that give the owners voting rights but only residual claims on the firm’s assets and income distribution.

12. In a(n) ________________, one firm combines with another firm in the same industry.

13. ________________ is generally defined as any firm that is independently owned and operated, that is not dominant in its market, and that meets a variety of size standards for income and number of employees.

14. A(n) ________________ is a legal organization whose assets and liabilities are separate from those of its owner(s).

15. A business that is owned by one person is a(n) ________________.

16. A(n) ________________ is an organization in which the owners operate collectively.

17. ________________ are shares that give the owners limited voting rights, and the right to receive dividends or assets before the owners of common stock.

18. A corporation incorporated in another country that does business in the United States is called a(n) ________________

19. ________________ means an organization is owned and operated by a government unit.

20. Two or more persons who operate a business as co-owners form a(n) ________________.
21. __________________________ is a contractual business agreement between a manufacturer or supplier and a dealer.

22. The governing authority of a corporation, elected by the common stockholders, is called the __________________________.

23. An organization whose goals do not include pursuing a profit is known as a(n) __________________________.

24. __________________________ can elect to be taxed as partnership while maintaining the advantages of corporations.

25. When firms at different levels in the production and/or marketing process decide to combine into one company, a __________________________ has occurred.

26. __________________________ is money invested in a business by another business firm or group of individuals in exchange for an ownership share.

27. When two or more firms combine to make one company, a __________________________ has occurred.

28. Owners of a corporation due to their purchase of stock in the corporation are known as __________________________.

29. A(n) __________________________ is an organization that provides low-cost common facilities and services to small, start-up businesses.

30. A(n) __________________________ is a federally licensed investment group that makes loans to small firms.

31. A(n) __________________________ is a written document that provides an orderly statement of a company’s goals, the methods by which it intends to achieve those goals, and the standards by which it will measure achievements.

32. A corporation that has been incorporated in a state other than the one in which it is operating in is known as a(n) __________________________.

33. A partnership between companies formed for a specific undertaking is called a(n) __________________________.

Analysis of Learning Objectives

Learning Objective 5.1: Distinguish between small and large businesses.

Multiple Choice

1. The Small Business Administration defines a small business as:
   a. independently owned and managed.
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b. a firm that is not dominant in its industry.
c. a firm that meets industry-specific size standards for income or number of employees.
d. all of the above.

2. The federal government agency that is set up to work with small businesses is the:
   a. BBC.
   b. SBC.
   c. FTC.
   d. SBA.

3. Which of the following industries tends to attract small business?
   a. retailing
   b. agriculture
   c. services
   d. construction
   e. all of the above

4. Home-based businesses:
   a. are illegal in most states.
   b. don’t have to pay income taxes.
   c. take advantage of the internet and the availability of communication devices.
   d. account for fewer than 50% of firms with revenues of $25,000 or less.

Learning Objective 5.2: Discuss the contributions of small businesses to the economy.

True or False

1. ______ It is fair to say that a strong small business sector is the backbone of the private enterprise system.

2. ______ Many of today’s large businesses were started by entrepreneurs.

3. ______ In the United States, the number of small businesses is declining.

4. ______ Almost three-fourths of all new jobs are created by small businesses.

5. ______ More than half of people in the nation’s private workforce are employed by small businesses.

6. ______ Small businesses account for barely one-quarter of the nation’s private GDP.

7. ______ Small businesses are more likely to hire women returning to the workforce and former welfare recipients than are larger businesses.

Learning Objective 5.3: Discuss the survival rate of small businesses.

Fill-In
Complete the sentence with the correct answer

1. Within two years, _________ percent of new businesses survive.
2. After five years, _________ percent of new businesses survive.
3. By the tenth year, _________ percent of new businesses have closed.

**Learning Objective 5.4:** Describe the features of an effective business plan.

**Multiple Choice**

1. A description of the firm’s target market and marketing plan, as well as detailed financial forecasts is known as:
   - a. the company’s financial mission.
   - b. the marketing executive summary
   - c. the financial and marketing section.
   - d. assessment of risks section.

2. A description of why the company was founded and what it intends to do accomplish its goals is known as:
   - a. plan and intent.
   - b. mission and vision.
   - c. goals and values.
   - d. objectives and ideas.

3. The section of the business plan that acknowledges and outlines a strategy for dealing with uncertainty is known as:
   - a. assessment of risks.
   - b. mission and vision.
   - c. business assessment.
   - d. danger signs.

4. The who, what, where, when, why, and how are answered in:
   - a. the company’s mission.
   - b. the executive summary
   - c. the financial and marketing section.
   - d. the assessment of risks section.

**Learning Objective 5.5:** Describe funding opportunities for small business, including the role of the Small Business Administration.

**Short Answer**

List and discuss three major areas in which the Small Business Administration offers programs and services.

1.
Learning Objective 5.6: Explain how franchising can provide opportunities for both franchisors and franchisees.

True or False

1. ______ Franchising is a contractual business arrangement between a manufacturer or supplier and a dealer.

2. ____ A well-established franchise is cheaper to open than an independent small business.

3. _____ Many franchisors offer training services for franchisees and their employees.

4. _____ Major advantages of franchises include a tested management system, name recognition, and a proven business model.

5. _____ The buyer of a franchise is known as the franchisor.

6. _____ One franchise unit can suffer from the actions or poor performance of other units of the same franchise.

7. _____ Franchising offers entrepreneurs greater independence and flexibility than other types of small businesses.

Learning Objective 5.7: Outline the three main legal forms of business ownership and summarize the features of businesses owned by employees and families, as well as not-for-profit organizations.

Multiple Choice

1. The most widely used form of business ownership is:
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a. general partnership. c. corporation.
b. sole proprietorship. d. limited partnership.

2. Additional capital is most easily obtained if the form of ownership is a:
   a. general partnership. c. corporation.
   b. sole proprietorship. d. limited partnership.

3. Limited financial liability is the most important advantage of which form of ownership?
   a. general partnership. c. corporation.
   b. sole proprietorship. d. all of the above.

4. A corporation in which employees share in whatever profit their company earns is known as:
   a. closely-held corporations. c. worker-funded corporations.
   b. stock-ownership corporations. d. employee-owned corporations.

5. These types of firms are known as the backbone of American business:
   a. general partnership c. corporations
   b. family-owned business d. none of the above

6. These types of organizations are commonly found in sectors such as museums, libraries, and hospitals:
   a. general partnership c. not-for-profits.
   b. sole proprietorship d. corporations.

True or False

7. ______ Sole proprietorships give owners ease of formation and dissolution, maximum flexibility, and the owner retains all the after tax profits.

8. ______ Sole proprietorships suffer from financial limitations and unlimited financial liability.

9. ______ Like sole proprietorships, partnerships are easy to form and dissolve.

10. ______ Major advantages that can be achieved through the partnership form of ownership include complimentary management skills and expanded financial capability.

11. ______ Corporations face fewer tax disadvantages and legal restrictions than other forms of business ownership.

Learning Objective 5.8: Describe public and collective (cooperative) business ownership.
Multiple Choice

1. When a group of wheat farmers collectively purchases a grain elevator, this is an example of:
   a. private ownership.  c. cooperative ownership.
   b. public ownership.  d. employee ownership.

2. If the city of Los Angeles owns a parking garage on Main Street, the garage is said to be:
   a. privately owned.  c. cooperatively owned.
   b. publicly owned.  d. collectively owned.

3. These types of firms result when private investors are unwilling to invest in a high-risk project:
   a. public ownership.  c. cooperative ownership.
   b. employee ownership.  d. a firm going private.

4. These types of firms are commonly found among agricultural businesses:
   a. employee-owned firms.  c. cooperatives.
   b. not-for-profit corporations.  d. all of the above.

Learning Objective 5.9: Identify types of corporations and the levels of corporate management.

True or False

1. ______ Top managers include job titles like CEO, CFO, COO, and CIO.

2. ______ Top managers are responsible for the day-to-day operational functions of the firm.

3. ______ Managers who directly supervise employees and coordinate day-to-day operations of the firm are known as supervisory managers.

4. ______ The board of directors is elected by the corporation’s common stockholders and appoints top management.

5. ______ A corporation that operates outside the state of incorporation is know as a domestic corporation

6. ______ A corporation that operates outside the country of incorporation is know as an alien corporation.

Learning Objective 5.10: Describe mergers, acquisitions and joint ventures.

Multiple Choice
1. When two or more firms combine to form one company, we say that the firms have:
   a. practiced divestiture.  
   b. been taken private.  
   c. become a cooperative.  
   d. merged.  

2. When one firm purchases the property and assumes the liabilities of another firm, there has been a(n):
   a. vertical merger.  
   b. horizontal merger.  
   c. acquisition.  
   d. divestiture.  

3. If a sporting goods manufacturer combines with a firm that operates sporting goods retailers, this would be an example of:
   a. a vertical merger.  
   b. a horizontal merger.  
   c. a conglomerate merger.  
   d. an employee ownership arrangement.  

4. If this sporting goods manufacturer combined with a food company, this would be an example of:
   a. a vertical merger.  
   b. a horizontal merger.  
   c. a conglomerate merger.  
   d. public ownership.  

5. If this sporting goods manufacturer combines with a manufacturer of tennis nets, this would be an example of:
   a. a vertical merger.  
   b. a horizontal merger.  
   c. a conglomerate merger.  
   d. a divestiture.  

Self Review

True or False

1. ______ Most businesses in the United States are organized as corporations.

2. ______ The quickest and simplest form of business ownership to start is the sole proprietorship.

3. ______ The government usually offers small businesses the option of foregoing the paperwork required of larger businesses.

4. ______ A partnership is defined as an association of two or more persons who are co-owners of a business.
5. ______ In a partnership, the death of one partner does not affect the business in any way.

6. ______ Many small business owners get added help in lowering costs by involving family members who often contribute without being paid.

7. ______ A Limited Liability Company (LLC) is governed by an operating agreement similar to a partnership agreement with the advantage of limited liability for owners.

8. ______ A franchise owner typically can generate profits faster than an independent business owner can.

9. ______ On average, more than 60% of small businesses dissolve within six years of being formed.

10. ______ The SBA will lend money to anyone with a really good idea.

11. ______ A corporation is a legal entity separate from the owners.

12. ______ A conglomerate merger is a merger of unrelated firms.

13. ______ Poor management is a frequently cited reason for small business failure.

14. ______ An organization that is operated collectively by its owners is a cooperative.

15. ______ The type of stock that entitles owners to voting rights and represents the true ownership of the corporation is referred to as common stock.

16. ______ Fewer than 20% of businesses in the United States qualify as small businesses.

17. ______ A Small Business Investment Company (SBIC) is an investment group that funds small businesses under an SBA license.

18. ______ The number of minority-and women-owned businesses is increasing.

19. ______ An important disadvantage of sole proprietorships is lack of continuity.

20. ______ Because of their many disadvantages, sole proprietorships have largely become a thing of the past.

21. ______ Small business plays a key role in international trade, accounting for over 30% of U.S. exports.

**Multiple Choice**

1. One advantage of purchasing a franchise is:
   
   a. the purchaser is guaranteed success.

   b. the franchisee gets a tested business model.
c. there is a great deal of operational independence for the franchisee.
d. it is usually a cheaper way to open a new business than starting from scratch.

2. When managers or a group of stockholders buy up all of a firm’s stock, the firm then becomes:
   a. a privately owned corporation.  c. an LLC.
   b. a cooperative.  d. a joint venture.

3. When two firms in the same industry merge, it is called a(n):
   a. conglomerate merger.  c. horizontal merger.
   b. vertical merger.  d. acquisition.

4. A corporation chartered in another nation but operating in the United States is known as a(n):
   a. domestic corporation.  c. alien corporation.
   b. foreign corporation.  d. national corporation.

5. Stockholders who have a prior claim to dividends and assets are known as:
   a. creditors.  c. common stockholders.
   b. preferred stockholders.  d. partners.

6. The tier of management responsible for coordinating the day-to-day operations of a firm is:
   a. top management.  c. supervisory management.
   b. middle management.  d. the board of directors.

7. The purpose of a business plan should be to:
   a. clarify the entrepreneur’s ideas for a business.
   b. create a document that can be shown to potential investors, lenders, or suppliers.
   c. decide upon the business’s organization and structure.
   d. spell out marketing and financial plans.
   e. all of the above.

8. If one firm acquires the property and assumes the obligations of another, it is called a(n):
   a. cooperative.  c. acquisition.
   b. merger.  d. joint venture.

9. Employee ownership:
   a. is situation in which a firm’s workers buy shares of stock in the business.
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b. is growing.
c. means employees can share in whatever profits their company earns.
d. all of the above.

10. When a government agency or unit owns and operates an organization, it is known as:
   a. private ownership. c. conglomerate ownership.
   b. public ownership. d. employee ownership.

11. The formal document that must be submitted to the state in order to form a corporation is known as:
   a. a business plan. c. a corporate charter.
   b. a corporate merger. d. corporate management.

12. The group who is elected by stockholders and who hires top management is called:
   a. the Board of Directors. c. supervisory management.
   b. middle management. d. not-for-profit management.

13. The owners of a corporation are known as the:
   a. Board of Directors. c. partners.
   b. stockholders. d. management.

14. To ensure that small businesses receive a reasonable portion of government procurement contracts, certain government contracts (or portions of those contracts) are reserved for small businesses in what are known as:
   a. joint ventures. c. set-aside programs.
   b. business incubators. d. corporate assistance programs.

15. Business incubators:
   a. are generally sponsored by local community agencies.
   b. provide shared space and services for new small businesses.
   c. often offer management counseling and in-house mentors.
   d. all of the above.

Application Exercises

Application Exercise I
Daryl Fox is a self-employed real estate agent. For the past ten years, he has been advising shopping center developers on such things as type and size of centers for given locations. During the course of his business, he has become friendly with the Keller Development Company, which is presently organized as a sole proprietorship. Daryl Fox and Chuck Keller, president of the Keller Development Company, are discussing the possibility of going into business together. Daryl’s sister, Delores Reyes, is an accountant and has been employed by a large accounting firm for several years. She, too, would like to have her own business rather than work for someone else. The three of them have decided that they collectively have the necessary skills and funds to start a large-scale operation.

1. What legal form of business ownership should you recommend? Why have you selected that form?

2. To protect Daryl Fox, Chuck Keller, and Delores Reyes, which form would you not recommend? Why did you make this decision?

3. Do you anticipate any problem areas in this arrangement? If yes, what problems?

4. How would this endeavor benefit Mr. Fox? Mr. Keller? Mrs. Reyes?

Application Exercise II
Winning the state lottery netted Albert DeLuca slightly over $100,000. His good friend Carla Hall is a talented jewelry designer, but does not have any money. Carla suggested that the two of them form a partnership, with Albert investing half his winnings and Carla contributing her talents. They decided on a general partnership. About two weeks later Al left for an around-the-world vacation. Carla stayed on to run the business. When Al returned home eight months later, he found that both Carla and the $50,000 were gone. The next day the creditors of the business came to Al with bills in excess of $80,000.

1. What is Al’s liability?

2. What is Carla’s liability?

3. If you met Al when he won the lottery, what advice would you have given him?

Short Essay Questions

1. What advantages do small businesses bring to the U.S. economy? What disadvantages must successful small businesses overcome?

2. What is franchising? How important is franchising as a form of small business? What are the advantages and disadvantages franchisees can expect?
3. Name and define the three legal structures of business ownership, citing their respective advantages and disadvantages.

4. Define and distinguish a merger and an acquisition. What are the major types of mergers?