

Entrepreneurship

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Lecture 5

جامعة الجميع الذكية

تسعى لتكون الكيان الأول الذي يتبنى مبدأ المجتمع التعليمي
التعاوني ويقدم العلم مقابل العمل لتنمية وبناء المجتمعات.

FORMS OF BUSINESS OWNERSHIP AND BUYING AN EXISTING BUSINESS

Learning Objectives

1

Explain the advantages and disadvantages of a sole proprietorship and a partnership.

2

Describe the similarities and differences of the C corporation and the S corporation.

3

Understand the characteristics of the limited liability company.

4

Explain the process of creating a legal entity for a business.

Learning Objectives

5

Understand the advantages and disadvantages of buying an existing business.

6

Define the steps involved in the *right* way to buy a business.

7

Understand how the negotiation process works and identify the factors that affect it.

- There is no one “best” form of ownership.
- The best form of ownership depends on an entrepreneur’s particular situation.
- It is essential to understand the characteristics of each form of ownership and how well they match an entrepreneur’s business and personal circumstances.

Chapter 05

Factors Affecting the Choice



Tax considerations



Liability exposure



**Start-up and future
capital requirements**



Control



Managerial ability



Business goals



**Management
succession plans**



Cost of formation

Major Forms of Ownership



- Sole Proprietorship

- Partnership



- General Partnership



- Limited Partnership

- Corporation



- C Corporation



- S Corporation



- Limited Liability Company

Sole Proprietorships

Is a business owned and managed by one person.



1. **Simple to create:** It is easy and fast to launch a sole proprietorship.
2. **Least costly type of ownership to begin:** There is no need to create and file legal documents that are recommended for partnerships and required for corporations.
3. **Profit incentive:** Once the owner pays all of the companies' expenses, he or she can keep the remaining profits.
4. **Total decision-making authority:** Because the sole proprietors are in total control of their business, they can respond quickly to changes. The power to set the company's course of action is a **big motivational force**.
5. **No special legal restrictions:** The sole proprietorship is the least-regulated type of business ownership.
6. **Easy to discontinue:** If an entrepreneur wants to discontinue operations, he or she can close the business quickly even though he or she will still be personally liable for any outstanding debts and obligations the business cannot pay.



1. **Unlimited personal liability:** The owner is personally liable for all the business's debts. In a proprietorship, the owner is the business. The proprietor owns all of the business's assets, and if the business fails, creditors can force the sale of these assets to cover the debts.
2. **Limited skills and capabilities:** The sole proprietor may not have the range of skills that is required to run a successful business. Many businesses fail because owners do not have the skills, knowledge, and experience in areas that are critical to business success.
3. **Feelings of isolation:** The sole proprietor may feel isolated because there is no one else to turn to for help when solving problems and getting feedback on a new idea.



4. **Limited access to capital:** Many proprietors have put all the resources they have into their businesses and used their personal assets as collateral to get loans, making it difficult to borrow more money.
5. **Lack of continuity of the business:** If the proprietor dies, retires, or is unable to run the business, the business automatically terminates. Unless a family member or employee can take over the business (which means that person is now the sole proprietor), the business will disappear.

PARTNERSHIP

Is an association of two or more people who co-own a business for the purpose of making a profit.



A partnership is an association of two or more people who co-own a business for the purpose of making a profit.

A Partnership Agreement is a document that states in writing the terms under which the partners agree to operate the partnership and that protects each partner's interest in the business.

Advantages of partnership



1. Easy and inexpensive to establish



2. Complementary skills of partners: the parties' skills and abilities usually complement one another, strengthening the company's managerial foundation



3. Division of profits: There are no restrictions on how partners distribute the company's profits as long as they are consistent with the partnership agreement and do not violate the rights of any partner. The partnership agreement should articulate each partner's contribution to the business and his or her share of the profits



4.



Larger pool of capital: The partnership form of ownership can significantly broaden the pool of capital available to a business.

- When partners share in owning, operating, and managing a business, they are **general partners**.
- General partners have unlimited liability for the partnership's debts and usually take an active role in managing the business. Every partnership must have at least one general partner, although there is no limit on the number of general partners a business can have.

Types of Partners

- **General partners:**
 - Take an active role in managing a business.
 - Have unlimited liability for the partnership's debts.
 - Every partnership must have at least one general partner.
- **Limited partners:**
 - are financial investors in a partnership
 - Cannot participate in the day-to-day management of a company.
 - Have limited liability for the partnership's debts.
 - If the business fails, they lose only what they have invested in it and no more.

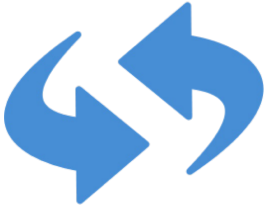
Advantages of partnership



- A limited partnership can attract investors by offering them limited liability and the potential to realize a substantial return on their investments if the business is successful. Many individuals find it very profitable to invest in high-potential small businesses but only if they avoid the disadvantages of unlimited liability while doing so.
- Two types of limited partners:
 1. **Silent partners:** Not active in a business but are generally known to be members of the partnership
 2. **Dormant partners:** Neither active nor generally known to be associated with the business



5. Minimal Government Regulation



6. **Flexibility:** Although not as flexible as a sole proprietorship, a partnership can generally react quickly to changing market conditions because the partners can respond quickly and creatively to new opportunities. In large partnerships, however, getting partners' approval can slow a company's strategic actions.



- 1. Unlimited liability of at least one partner**
- 2. Limited capital accumulation compared with corporate form**
- 3. Difficulty in disposing of partnership interest (shares) without dissolving the partnership**
- 4. Potential for personality and authority conflicts**
- 5. Partners bound by law of agency**



1. Unlimited liability of at least one partner

- At least one member of every partnership must be a general partner.
- The general partner has unlimited personal liability for any debts that remain after the partnerships assets are exhausted.
- In addition, general partners' liability is *joint and several*, which means that creditors can hold all general partners equally responsible for the partnership's debts or can collect the entire debt from just one partner.



Unlimited Liability



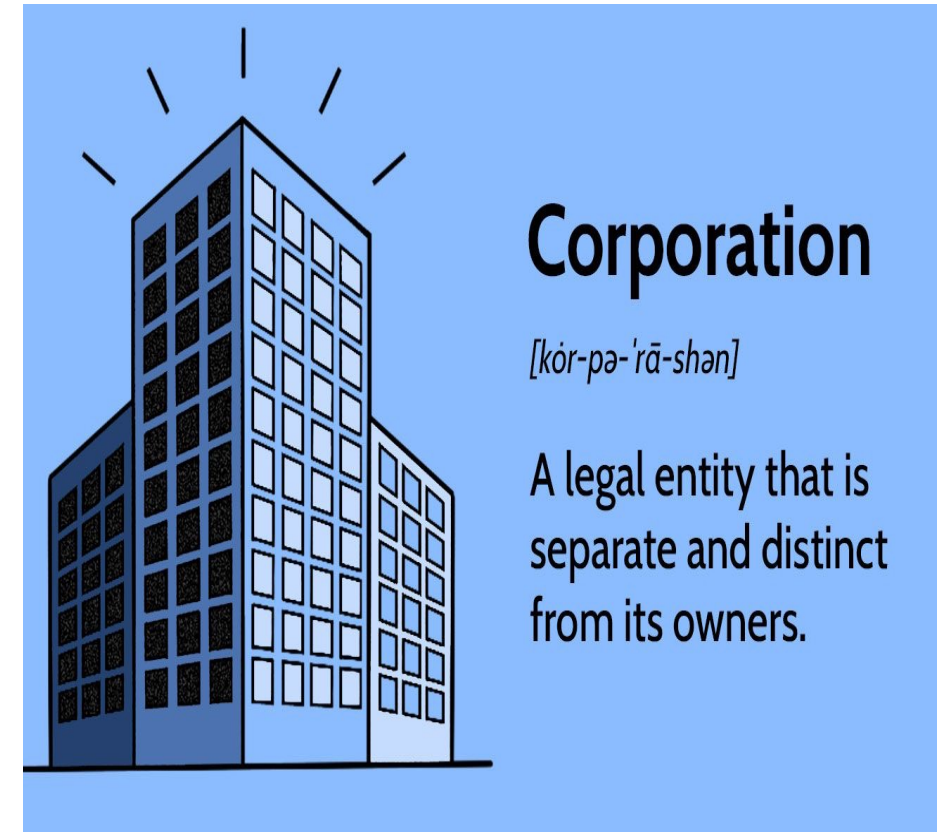
2. **Capital accumulation:** Although the partnership form of ownership is superior to the proprietorship in its ability to attract capital, it is generally not as effective as the corporate form of ownership.
3. **Difficulty in disposing of partnership interest without dissolving the partnership.**
4. **Potential for personality and authority conflicts:** Making sure that partners' work habits, goals, ethics, and general business philosophy are compatible is an important step in avoiding a nasty business divorce.
5. **Partners bound by law of agency:** Each partner is an agent for the business and can legally bind the partnership and, hence, the other partners, to contracts—even without the remaining partners' knowledge or consent.

CORPORATE

Is a separate legal entity from its owners.



- Types of corporations:
 - **Publicly held:** a corporation that has a large number of shareholders and whose stock usually is traded on one of the large stock exchanges.
 - **Closely held:** a corporation in which shares are controlled by a relatively small number of people, often family members, relatives, or friends.



Avoiding Legal Tangles

- Identify the company as a corporation by using “Inc.” or “Corporation” in the business name.
- File all reports and pay all necessary fees required by the state in a timely manner.
- Hold annual meetings to elect officers and directors.
- Keep minutes of every meeting (formal and informal) of the officers and directors.



- Be sure that the corporation's board makes all major decisions.
- Make it clear that the business is a corporation – officers should sign all documents in the corporation's name.
- Keep corporate assets and the personal assets of the owners separate.

C CORPORATE

- Traditional form of incorporation.
- Pays taxes at the corporate tax rate and stockholders also pay taxes on dividends they receive at their individual tax rates.
- **Double taxation:** a disadvantage of the corporate form of ownership in which the corporation's profits are taxed twice, once at the corporate rate and again at the individual rate on the portion of profits distributed to shareholders as dividends.



- **Limited liability:** Generally, corporate shareholders are not personally liable for the debts, liabilities, and obligations of the C corporation.
- **No limit on shareholders:** C corporations are not limited to 100 shareholders. C-corps are an excellent option for businesses that intend to go public or have a large number of shareholders.
- **Open to international business owners:** A C corporation's shareholders are not limited by citizenship or residence. In contrast, S corporations restrict shareholders to citizens or residents.
- **Ability to take on investors:** C corporations aren't limited to non-entity investors. This 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.
- **Tax-deductible business expenses:** A C corporation can deduct business expenses like salaries, rents, advertising costs, and employee benefits on its tax return.



- **Double taxation:** C corporations are taxed first on their profits at the corporate level and then as dividends on shareholders' individual tax returns.
- **Expensive to set up:** In addition to state-specific filing fees between \$50 and \$500, filing for C corporations is a complex process that may require you to hire an attorney.
- **Heavily regulated:** C corporations must follow strict meeting, record-keeping, and other operational requirements.
- **No personal deduction of losses:** Unlike business structures like LLCs, S corporations, and partnerships, you can't deduct the losses of your C corporation on your personal tax return. These deductions are limited to the corporation's return.

S Corporation



S
corporation

- No different from any other corporation from a legal perspective.
- An S corporation is taxed like a partnership, passing all of its profits (or losses) through to individual shareholders.

Key Corporation Type Differences

C Corp	S Corp
• Double tax • Can deduct charitable donations • Easier filing process • Unlimited number of shareholders • Various stock options	• Single pass-through tax • More tax deduction options • Filing requires more documentation • Ownership/shareholder restrictions • One stock option

Source: <https://www.eztexting.com/resources/start-your-business/c-corp-vs-s-corp>

C&S Corp Advantages and Disadvantages

C Corp		S Corp	
ADVANTAGES	DISADVANTAGES	ADVANTAGES	DISADVANTAGES
• Easier to form and file • Unlimited number of and few restrictions on types of shareholders • Multiple classes of stock • More possibilities for getting equity financing and growing your business • Can go public to become publicly traded	• Double taxation • Larger number of shareholders may not feel heard	• Single pass-through taxation • Potential for more tax deductions	• No ability to go public • 100 shareholders maximum • One class of stock, so limited investor opportunities • More complex filing process • More restrictions mean more scrutiny from the IRS

Limited Liability Company (LLC)

Is a business structure that protects its owners from personal responsibility for its debts or liabilities.

- Resembles an S Corporation but is *not* subject to the same restrictions.
- The **limited liability company (LLC)**, like an S corporation, offers its owners limited personal liability for the debts of the business, providing a significant advantage over sole proprietorships and partnerships. LLCs, however, are not subject to many of the restrictions currently imposed on S corporations and offer more flexibility than S corporations. For example, S corporations cannot have more than 100 shareholders, and none of them can be foreigners or corporations..



Characteristics of the Major Forms of Ownership

Characteristic	Sole Proprietorship	General Partnership	Limited Partnership	C Corporation	S Corporation	LLC
Definition	A for-profit business owned and operated by one person	A for-profit business jointly owned and operated by two or more people	One general partner and one or more partners with limited liability and no rights of management	An artificial legal entity separate from its owners and formed under state and federal laws	An artificial legal entity that is structured like a C corporation but taxed by the federal government like a partnership	A business entity that provides limited liability like a corporation but is taxed like a partnership; owners are referred to as <i>members</i>
Ease of formation	Easiest form of business to set up; if necessary, acquire licenses and permits, register fictitious name, and obtain taxpayer identification	Easy to set up and operate; a written partnership agreement is highly recommended; must acquire an employer ID number; if necessary, register fictitious name	File a Certificate of Limited Partnership with the secretary of state; name must show that business is a limited partnership; must have written agreement and must keep certain records	File articles of incorporation and other required reports with the secretary of state; prepare bylaws and follow corporate formalities	Must meet all criteria to file as an S corporation; must file timely election with the IRS (within two and a half months of first taxable year)	File articles of organization with the secretary of state; adopt operating agreement and file necessary reports with secretary of state; the name must show that it is an LLC
Owner's personal liability	Unlimited	Unlimited for general partners; limited for limited partners	Limited	Limited	Limited	Limited
Number of owners	One	Two or more	At least one general partner and any number of limited partners	Any number	Maximum of 100 with restrictions as to who they are	One (a few states require two or more)
Tax liability	Single tax: personal tax rate	Single tax: partners pay on their proportional shares at their individual rate	Same as general partnership	Double tax: corporation pays tax, and shareholders pay tax on dividends distributed	Single tax: owners pay on their proportional shares at individual rate	Single tax: members pay on their proportional shares at individual rate
Current maximum tax rate	39.6%	39.6%	39.6%	35% corporate plus 39.6% individual	39.6%	39.6%
Transferability of ownership	Fully transferable through sale or transfer of company assets	May require consent of all partners	Same as general partnership	Fully transferable	Transferable (but transfer may affect S status)	Usually requires consent of all members
Continuity of the business	Ends on death or insanity of proprietor or on termination by proprietor	Dissolves on death, insanity, or retirement of a general partner (business may continue)	Same as general partnership	Perpetual life	Perpetual life	Perpetual life
Cost of formation	Low	Moderate	Moderate	High	High	High
Liquidity of the owner's investment in the business	Poor to average	Poor to average	Poor to average	High	High	High
Ability to raise capital	Low	Moderate	Moderate to high	Very high	High	High
Formation procedure	No special steps required other than buying necessary licenses	No written partnership agreement required (but highly advisable)	Must comply with state laws regarding limited partnership	Must meet formal requirements specified by state law	Must follow same procedures as C corporation, then elect S status with IRS	Must meet formal requirements specified by state law

Buying a Business

Key Questions to Consider *Before* Buying a Business

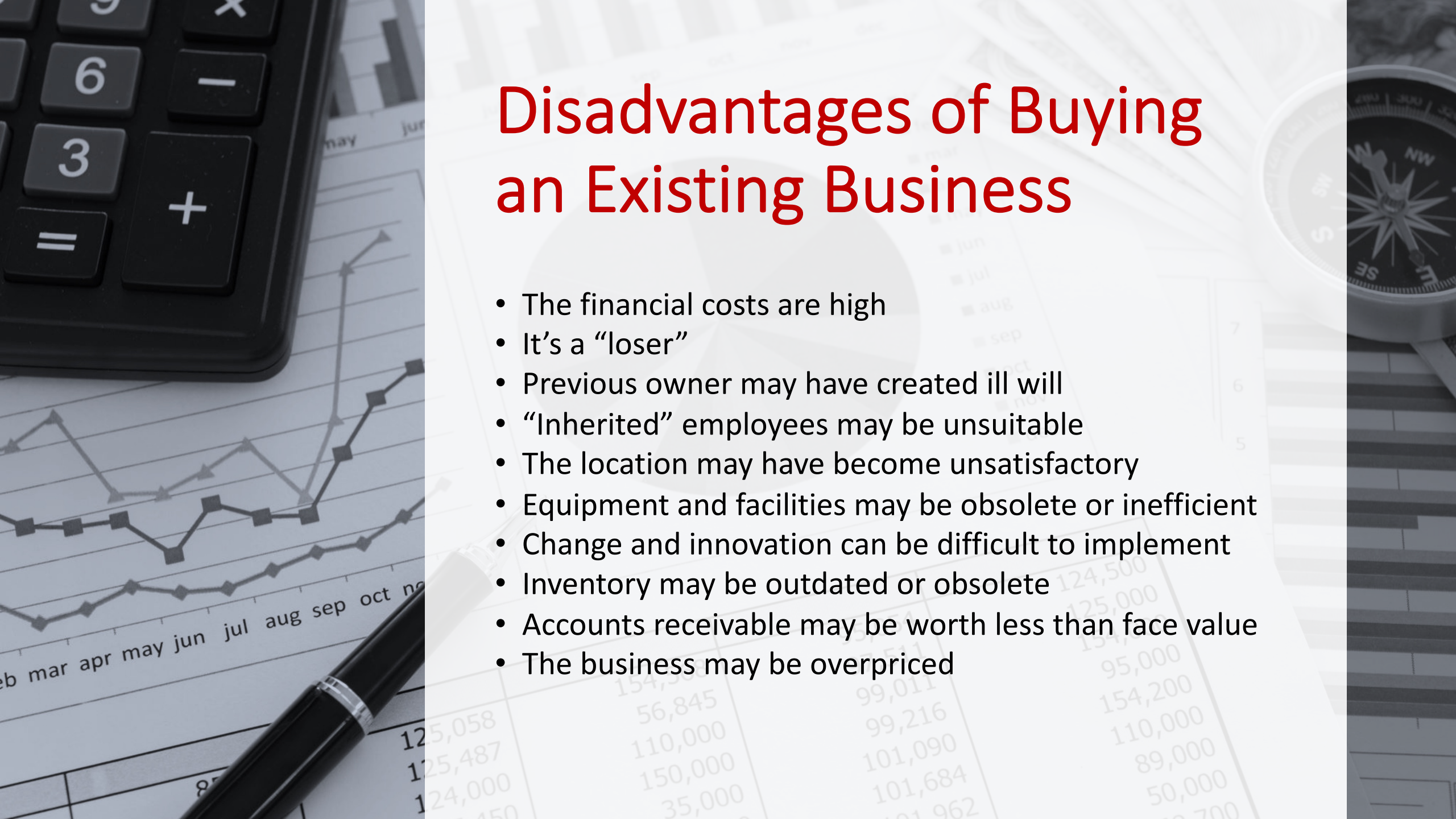
- Is the right type of business for sale in the market in which you want to operate?
- What experience do you have in this particular business and the industry in which it operates? How critical is experience in the business to your ultimate success?
- What is the company's potential for success?
- What changes will you have to make – and how extensive will they have to be – to realize the business's full potential?

Key Questions to Consider *Before* Buying a Business

- What price and payment method are reasonable for you and acceptable to the seller?
- Is the seller willing to finance part of the purchase price?
- Will the company generate sufficient cash to pay for itself and leave you with a suitable rate of return on your investment?
- Should you be starting a business and building it from the ground up rather than buying an existing one?

Advantages of Buying an Existing Business

- It may continue to be successful
- It may already have the best location
- Employees and suppliers are established
- Equipment is already installed
- Inventory is in place and trade credit is established
- It's turnkey
- New owners can "hit the ground running"
- New owners can use the previous owner's experience
- Financing is easier to obtain



Disadvantages of Buying an Existing Business

- The financial costs are high
- It's a "loser"
- Previous owner may have created ill will
- "Inherited" employees may be unsuitable
- The location may have become unsatisfactory
- Equipment and facilities may be obsolete or inefficient
- Change and innovation can be difficult to implement
- Inventory may be outdated or obsolete
- Accounts receivable may be worth less than face value
- The business may be overpriced

Acquiring a Business

- Study: 50 to 75% of all business sales that are initiated fall through.
- The *right* way:
 - Analyze your skills, abilities, and interests.
 - Develop a list of criteria
 - Prepare a list of potential candidates.
 - Investigate and evaluate candidate businesses and select the best one.

Acquiring a Business

- Explore financing options
 - Potential source: the seller
- Negotiate a reasonable deal
- Ensure a smooth transition
 - Communicate with employees
 - Be honest
 - Listen
 - Consider asking the seller to serve as a consultant through the transition

To avoid blowing a deal or making costly mistakes, an entrepreneur- to-be should follow these seven steps:

1. Conduct a self-inventory, objectively analyzing skills, abilities, and personal interests to determine the type(s) of business that offer the best fit.
2. Develop a list of the criteria that define the “ideal business” for you.
3. Prepare a list of potential candidates that meet your criteria.
4. Thoroughly investigate the potential acquisition targets that meet your criteria. This *due diligence process* involves practical steps, such as analyzing financial statements and making certain that the facilities are structurally sound. The goal is to minimize the pitfalls and problems that arise when buying any business.
5. Explore various financing options for buying the business.
6. Negotiate a reasonable deal with the existing owner.
7. Ensure a smooth transition of ownership.

Negotiating the Deal

- Go into negotiations with a list of objectives ranked in order of priority.
- Try to understand what the seller's priorities are.
- Work to establish a cooperative relationship based on honesty and trust.
 - Avoid an “if you win, then I lose” mentality
 - Look for areas of mutual benefit

- Buying or selling a business always involves a negotiation, and so do many other business activities, whether an entrepreneur is dealing with a bank, a customer, or a vendor
- To become a better negotiator an entrepreneur should:
 1. Prepare
 2. Remember the difference between a “position” and an “interest.”
 3. Develop the right mindset.
 4. Always leave an escape hatch.
 5. Keep your emotions in check
 6. Don’t fall into the “rules” trap.
 7. Sometimes it’s best to remain silent

Negotiating to acquire a new business

1. Prepare:

- The formula for a successful negotiation is 90 percent preparation and 10 percent bargaining.
- The key is to learn as much as possible about the party with whom you will be negotiating, the issues that are most important to him or her, and his or her likely positions on those issues.
- Preparation for a negotiation also should include a statement of the outcome one desire from the negotiation.
- Negotiator also should write down what he/she thinks his/her *counterpart's* goals from the negotiation are.

Negotiating to acquire a new business

2. Remember the difference between a “position” and an “interest.”

- The outcome a person wants from a negotiation is his or her position.
- What is much more important, however, is his or her **interest**, the reason behind the position he or she hopes to achieve.
- Focusing strictly on their positions usually leads two parties into a win–lose mentality in a negotiation in which they try to pound one another into submission. When the parties involved in a negotiation **focus on their interests rather than on their positions**, however, they usually discover that there are several different solutions that both will consider acceptable and reasonable.



3. Develop the right mindset.

- Negotiation should not be viewed as win-lose situation. The goal is to work toward a mutually beneficial agreement that both parties consider to be fair and reasonable.
- Successful negotiations almost always involve compromise on both sides, meaning that *neither* party gets *everything* he or she wanted.
- In other words, successful negotiators see a negotiation not just as deal making but also as problem solving.



4. Always leave an escape hatch

- In any negotiation, you should be prepared to walk away without making a deal.
- Doing so, however, requires you to define what negotiation experts call a best alternative to a negotiated agreement (BATNA), which is the next best alternative to a negotiated outcome.
- You cannot determine whether a negotiated agreement is suitable unless you know what your alternatives are, and one alternative (although not always the best one) is to walk away from the negotiation without an agreement—your BATNA.
- Although you may never need to use your BATNA, it is good to know you have it in your “back pocket” to give you confidence and help you remain calm throughout the negotiating process.

5. Keep your emotions in check:

- Negotiations could become emotionally charged, especially if those involved allow their egos to enter into the process.
- It is always best to abide by the golden rule of negotiating: treat others the way you want to be treated in the negotiation.
- Be fair but firm.

6. Don't fall into the “rules” trap:

- Successful negotiations involve give-and-take by both parties.
- There are no hard and fast rules that prohibit either party from making changes in contracts or agreements throughout the negotiating process.
- Nothing is settled until both parties sign the final documents. Until then, the parties can change anything.
- The goal is not to win specific points in the negotiating process; the goal is to reach an agreement viewed as fair and reasonable to both sides of the negotiation.



7. Sometimes it's best to remain silent

- A common mistake many people make in the negotiation process is talking too much.
- Not only does remaining silent allow you to listen to the other party, but it also encourages the other party to make the first offer.
- Some people are disconcerted by prolonged periods of silence and begin talking, only to erode the strength of their negotiation base.

thanks for
listening!