

# CHAPTER

# 8

# Business Organizations

## Why It's Important

*How could you start a business and operate it successfully? Which has more advantages—sole ownership of a business or a partnership? This chapter will explain how you can start a business as well as the different ways that businesses are organized.*



To learn more about sole proprietorships, partnerships, and corporations, view the **Economics & You** Chapter 4 video lesson: **Business Organizations**

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**Chapter Overview** Visit the *Economics Today and Tomorrow* Web site at [ett.glencoe.com](http://ett.glencoe.com) and click on **Chapter 8—Chapter Overviews** to preview chapter information.

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**CONTENTS**

# Starting a Business

## COVER STORY

KIPLINGER'S PERSONAL FINANCE MAGAZINE, DECEMBER 1998



The perfect place for your credit cards is in a Beeping Wallet—a billfold with a microchip that beeps every 20 seconds when a credit card has been removed. It's both a last-gasp warning [to not spend money] and a reminder to replace the card, says David Kopel, the wallet's inventor, who says he came up with the idea after his wife lost a credit card.

### READER'S GUIDE

#### Terms to Know

- entrepreneur
- startup
- small business incubator
- inventory
- receipts

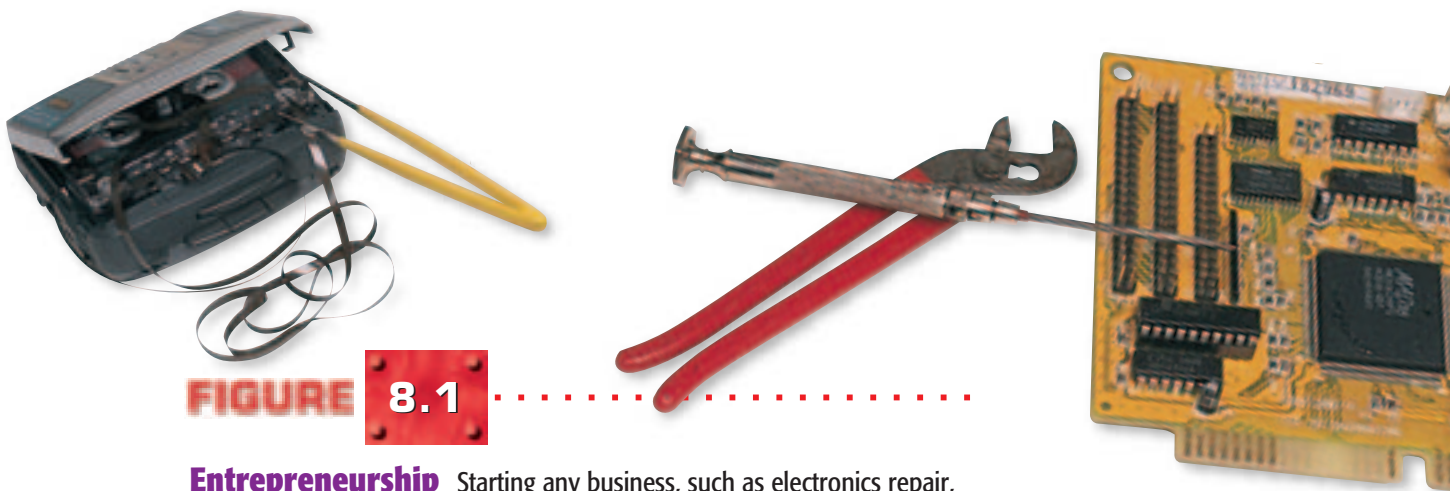
#### Reading Objectives

1. What things must be done before starting a business?
2. What four elements are involved in every business?

**H**ow many times have you seen a product for sale and said, “That was *my* idea”? Or you see an item, nod your head, and think, “That’s a good idea. I wonder how they thought of that”? Many new products and services arise from personal experience—as in the case of David Kopel’s Beeping Wallet. In this section, you’ll learn how to take your idea and start a business.

## Getting Started

Suppose that you have been tinkering with electronic equipment since you were a child. By now you can take apart and reassemble cassette and CD players, VCRs, most computers, and



**FIGURE 8.1**

**Entrepreneurship** Starting any business, such as electronics repair, is risky. *Why do people take the risk of becoming entrepreneurs?*

other electronic equipment without difficulty. You are so good at repairing this kind of equipment that you have been doing it for friends and relatives for some time. Then an idea occurs to you: Why not charge people for your services? Why not go into business for yourself? By starting your own business, you will become an entrepreneur.

A person who makes the decision to start a business is an **entrepreneur** because he or she is willing to take a risk. See **Figure 8.1**. People usually decide to start a business to gain profits, to “do something on their own,” or to be their own boss.

After making the decision to start a business, entrepreneurs must gather the relevant factors of production to produce their good or service and decide on the form of business organization that best suits their purposes. (You’ll learn about the types of business organizations in Sections 2 and 3.)

Anyone hoping to become an entrepreneur must also learn as much as possible about the business he or she plans to start. This process includes learning about the laws, regulations, and tax codes that will apply to the business.

**entrepreneur:** person who organizes, manages, and assumes the risks of a business in order to gain profits

**startup:** a beginning business enterprise

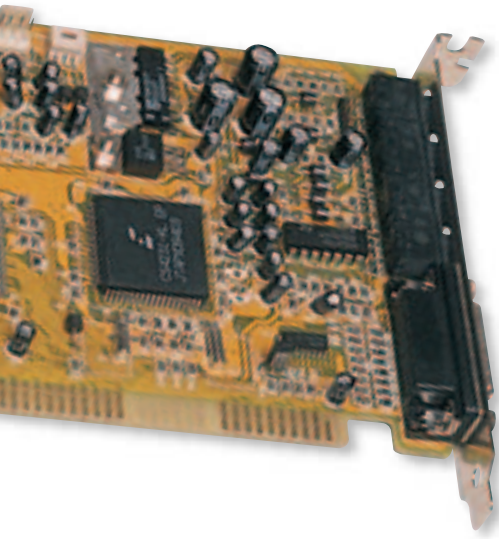
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**Student Web Activity** Visit the *Economics Today and Tomorrow* Web site at [ett.glencoe.com](http://ett.glencoe.com) and click on **Chapter 8—Student Web Activities** to learn more about the Small Business Administration.

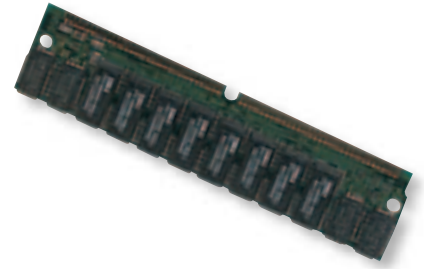
**Help From Government** For a person who wants to start a small business, help is available. The federal government’s Small Business Administration often helps finance **startups**, or new small businesses. State departments of commerce and community affairs also offer assistance. Many community college and university campuses have small business development centers that are federally funded to help a small business get started.



A **small business incubator** might also aid businesses in your area. Just as incubators help hatch chicks, there are business incubators that help “hatch” small businesses. They are often operated with state and federal funds. A small business incubator might provide a low-rent building, management advice, and computers. The incubator’s goal is to generate job creation and economic growth, particularly in economically depressed areas.

**small business incubator:** private- or government-funded agency that assists new businesses by providing advice or low-rent buildings and supplies

**Help From the Internet** Although new entrepreneurs can get help from government agencies, the Internet also provides a huge amount of information on how to start a business. By using search engines, you can find Web sites that explain everything from putting together a business plan to learning the “secrets to success.”



## Elements of Business Operation

Every business must consider four basic elements: expenses, advertising, record keeping, and risk.

**Expenses** You’ve probably heard the saying, “You have to spend money to make money.” This is true when considering business expenses: new equipment, wages, insurance, taxes, electricity, telephone service, and so on. And depending on the kind of job you do, you may need replacement parts. At first, you might buy parts only as you need them for a particular job. In time, you will find it easier to have an **inventory**, or supply of items that are used in your business. See *Part A* of **Figure 8.2** on page 210.

**inventory:** extra supply of the items used in a business, such as raw materials or goods for sale

Wages are an expense. Because you could be working for someone else and earning an income, you should pay yourself a wage equal to what you could earn elsewhere. It’s important not to forget this *opportunity cost* when you figure out the profits and losses your new business is making.

Will your business make a profit? Add your wages to your other expenses, including taxes. Then subtract your total expenses from your **receipts**, or the money income you’ve received from customers, and you will have your profit. Keep records of how much you owe and to whom, and of how much your business is taking in. You will need this information to do your taxes.

**receipts:** income received from the sale of goods and/or services; also, slips of paper documenting a purchase

## FIGURE 8.2

### Elements of Business Operation

#### A Expenses

*The supplies you need to do your job are included under expenses. Let's imagine that you want to start a painting business. As part of your expenses, you will need to purchase brushes, paint, and ladders. As your business grows, you might invest in paint sprayers or electric sanders so you can complete jobs more quickly. This new equipment will eventually add to your income, but will probably require more money than you have on hand at the startup phase of your business.*



#### B Advertising

*The cost of advertising often reduces profits substantially in the startup phase of a business. After you have several satisfied customers, however, information about your business may spread by word of mouth.*



#### C Record Keeping

*Maintaining accurate records of your expenses and receipts is vital—especially when you're doing your taxes.*



#### D Risk

*Many startups fail. If you work for a boss, your overall risks are usually small. As your own boss, your risks are greater, but so are the potential rewards. The profits you expect to make are your incentive for taking those risks.*



**Advertising** To start a business, you must make potential customers aware that your goods or services are available for a price. You could have flyers printed and distributed to advertise your business, as shown in *Part B* of **Figure 8.2**. You could also buy advertising space in newspapers or on various Web sites.

**Record Keeping** No matter how small your business, having a system to track your expenses and income is key to your success. Probably one of the first things you'll need is a computer. See *Part C* of **Figure 8.2**. You should also purchase or download from the Internet the programs that will allow you to track your expenses and receipts. These programs write checks, calculate your monthly profits and losses, tell you the difference between what you own and what you owe (called *net worth*), and so on.

The slips of paper that document your purchases of supplies—also known as *receipts*—must be filed in a safe place. Business purchases can be deducted from the amount of taxes you owe.

**Risk** Every business involves risks. You must balance the risks against the advantages of being in business for yourself. See *Part D* of **Figure 8.2**. For example, if you spend part of your savings to pay for advertising and equipment, you are taking a risk. You may not get enough business to cover these costs.



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## SECTION

## 1

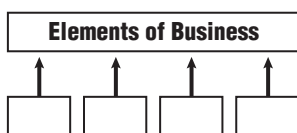
# Assessment

### Understanding Key Terms

- 1. Define** entrepreneur, startup, small business incubator, inventory, receipts.

### Reviewing Objectives

- 2.** What are at least three things you must do before starting a business?
- 3. Graphic Organizer** Create a diagram like the one below to explain the four elements common to all businesses.



### Applying Economic Concepts

- 4. Entrepreneurship** Think of a product or service that you would like to produce. Be sure to consider a business that you know something about or could easily find information about. Also research if there is a demand for that product or service. What initial expenses would you have as a startup?

### Critical Thinking Activity

- 5. Synthesizing Information** Using your answer to question 4, compile a table listing all expenses for your startup for one month. *For help in using tables, see page xvii in the Economic Handbook.*



## Technology Skills

# Using the Internet

To learn more about almost any topic imaginable, use the Internet—a global network of computers. Many features, such as E-mail, interactive educational classes, and shopping services, are offered on the Net. To get on the Internet, you need three things: (a) a personal computer or WebTV, (b) a modem—a device that connects your computer to a telephone line or cable, and (c) an account with an Internet service provider (ISP). An ISP is a company that enables you to log on to the Internet, usually for a fee.

1. Log on to the Internet and access a search engine.
2. Search by typing *small business incubator* in the search engine.
3. Scroll the list of Web pages that appears when the search is complete. Select a page to bring up and read or print.
4. If you get “lost” on the Internet, click on the “back arrow” key at the top of the screen until you find a site that looks familiar.
5. Continue selecting sites until you have enough information to write a short report on the help available to startups from small business incubators.

### Learning the Skill

After you are connected, the easiest way to access Internet sites is to use a “Web browser,” a program that lets you view and explore information on the World Wide Web.

The Web consists of many documents called “Web sites,” each of which has its own address, or Uniform Resource Locator (URL). Many URLs start with the keystrokes *http://*

If you don’t know the exact URL of a site, commercial “search engines” such as Yahoo! or Google can help you find information. Type a subject or name into the “search” box, then press Enter. The search engine lists available sites that may have the information you are looking for.

### Practicing the Skill

To learn how the Internet can help business startups, follow the steps listed on the left.

### Application Activity

Follow the above procedures to locate information about the number of women-owned businesses. Use the information you gather to create a chart or bar graph depicting the number, sales, and workforces of women-owned businesses.



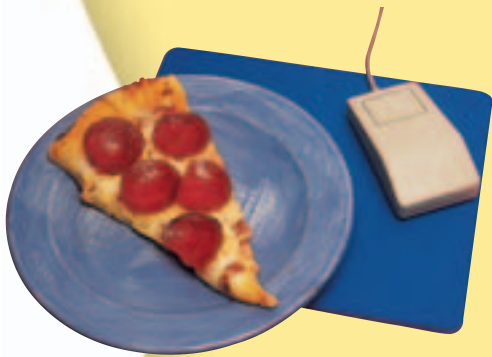
# Sole Proprietorships and Partnerships

## COVER STORY

NEWSWEEK, APRIL 5, 1999

In the movie *The Net*, Sandra Bullock played a victimized computer hacker who, in one scene, orders a pizza on her computer. The moment flashed by most moviegoers . . . , but it gave Tim Glass an idea—not for a better movie but an Internet

company. With three longtime friends and colleagues, [Glass] set about recruiting restaurants to post their menus online. The goal: point-and-click ordering. They called the company Cyberslice. . . .



## READER'S GUIDE

### Terms to Know

- sole proprietorship
- proprietor
- unlimited liability
- assets
- partnership
- limited partnership
- joint venture

### Reading Objectives

1. What are the advantages and disadvantages of a sole proprietorship?
2. What are the advantages and disadvantages of a partnership?

**B**usinesses can be organized in a number of ways. Some have one owner. Others, like Tim Glass's Cyberslice company, have multiple owners or partners. In this section, you'll learn that the two most common ways of organizing business in the United States are sole proprietorships and partnerships.

## Sole Proprietorships

The most basic type of business organization is the **sole proprietorship**, a business owned by one person. It is the oldest

**sole proprietorship:** *business owned and operated by one person*





form of business organization and also the most common. The colonies of Maryland and Pennsylvania were founded as sole proprietorships.

When we speak of a **proprietor**, we are referring to the owner of a business. The word *proprietor* comes from the Latin word *proprietas*, meaning “property.” A business is a kind of property.

The United States has more than 17 million such businesses, and many of them are small. For that reason, they usually are easier and less expensive to start and run. You probably have contact with many sole proprietorships every day without realizing it.

The biggest advantages of sole proprietorships are that the proprietor has full pride in owning the business and receives all the profits. The biggest disadvantage is that the proprietor has **unlimited liability**, or complete legal responsibility for all debts and damages arising from doing business. Personal **assets**, or items of value such as houses, cars, jewelry, and so on, may be seized to pay off business debts. **Figure 8.3** lists these and other advantages and disadvantages of operating a sole proprietorship.

**proprietor:** owner of a business

**unlimited liability:** requirement that an owner is personally and fully responsible for all losses and debts of a business

**assets:** all items to which a business or household holds legal claim

**partnership:** business that two or more individuals own and operate

## Partnerships

Earlier in this chapter, we imagined that you had started an electronics repair business. Suppose your business is doing so well that your workload leaves you little time to do anything else. You could expand your business by hiring an employee. However, you also need financial capital to buy new equipment, and you would rather not take out a loan. You decide to take on a partner.

The best solution is to look for someone who can keep books, order supplies, handle customers, and invest in the business. You offer to form a **partnership**, a business that two or more individuals own and operate. You sign a partnership agreement that is legally binding. It describes the duties of each partner, the division of profits, and the distribution of assets should the partners end the agreement.

Much like sole proprietorships, an advantage of partnerships is the pride of sharing ownership in a business—and contributing to it in a specialized way that benefits all the partners. A disadvantage is that, like the sole proprietor, the partners have unlimited liability. **Figure 8.4** on page 216 shows other advantages and disadvantages of partnerships.



**CAREERS**  
**Restaurant Manager**

Job Description	Qualifications
<ul style="list-style-type: none"><li>■ Select, order, and price menu items</li><li>■ Hire, train, and supervise employees</li><li>■ Keep records, prepare payroll, and maintain equipment</li></ul>	<ul style="list-style-type: none"><li>■ Bachelor's or associate degree in restaurant and food service management</li></ul>

**Median Base Salary:** \$31,720

**Job Outlook:** Average

—Occupational Outlook Handbook, 2002–03



**FIGURE 8.4**

## Advantages and Disadvantages of Partnerships

	Advantages	Disadvantages
<b>Profits and Losses</b>	<ul style="list-style-type: none"><li>• Losses are shared.</li><li>• Partners may survive a loss that might bankrupt a sole proprietor.</li></ul>	<ul style="list-style-type: none"><li>• Because partners share the risks, they also share the profits.</li></ul>
<b>Liability</b>		<ul style="list-style-type: none"><li>• Partners have unlimited liability for debts incurred in business.</li><li>• If a partner is unable to pay his or her share of a debt, the others must make up the difference.</li></ul>
<b>Management</b>	<ul style="list-style-type: none"><li>• Partnerships are usually more efficient than proprietorships.</li><li>• Each partner works in areas of the business that he or she knows most about or is best at doing.</li><li>• There are generally fewer government regulations.</li></ul>	<ul style="list-style-type: none"><li>• Decision making is often slow because of the need to reach agreement among several people.</li><li>• Disagreements can lead to problems in running the business.</li></ul>
<b>Taxes</b>	<ul style="list-style-type: none"><li>• Taxes are usually low because partners pay only personal income taxes on their share of profits.</li></ul>	
<b>Personal Satisfaction</b>	<ul style="list-style-type: none"><li>• Partners feel pride in owning and operating their own company.</li></ul>	<ul style="list-style-type: none"><li>• Arguments may result if partners do not get along with each other.</li></ul>
<b>Financing Growth</b>	<ul style="list-style-type: none"><li>• Partnerships combine capital, making more funds available to operate a larger, more profitable business.</li><li>• Creditors are often willing to lend more money to partnerships than to sole proprietorships.</li></ul>	<ul style="list-style-type: none"><li>• Partnerships can have trouble borrowing large amounts of capital.</li><li>• The amount borrowed is usually limited by the combined value of the business assets and the personal assets of the partners.</li></ul>
<b>Life of the Business</b>		<ul style="list-style-type: none"><li>• If one partner dies or leaves, the partnership must be ended and reorganized.</li><li>• The other partners may be unable or unwilling to continue operating, and the business may close—an uncertainty that is a risk to employees and creditors.</li></ul>

**Limited Partnerships** A **limited partnership** is a special form of partnership in which the partners are not equal. One partner is called the *general partner*. This person (or persons) assumes all of the management duties and has full responsibility for the debts of the limited partnership. The other partners are “limited” because all they do is contribute money or property. They have no voice in the partnership’s management.

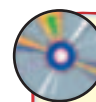
**limited partnership:** special form of partnership in which one or more partners have limited liability but no voice in management

The advantage to the limited partners is that they have no liability for the losses beyond what they initially invest. The disadvantage, of course, is that they have no say in how the business is run.

**Joint Ventures** Sometimes individuals or companies want to do a special project together. They do not have any desire to work together after the project is done. What they might do is form a **joint venture**—a temporary partnership set up for a specific purpose just for a short period of time.

**joint venture:** partnership set up for a specific purpose just for a short period of time

Suppose investors want to purchase real estate as a short-term investment. They may later plan to resell the property for profit. At that point, the joint venture ends.



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## SECTION

## 2

# Assessment

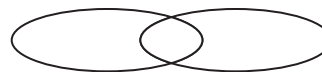
### Understanding Key Terms

1. **Define** sole proprietorship, proprietor, unlimited liability, assets, partnership, limited partnership, joint venture.

### Reviewing Objectives

2. Analyze the advantages and disadvantages of a sole proprietorship.
3. Analyze the advantages and disadvantages of a partnership.
4. **Graphic Organizer** Create a diagram like the one in the next column, then analyze the similarities and differences between partnerships and sole proprietorships. In your diagram, explain the characteristics that are unique to partnerships and sole proprietorships in the

outer part of each oval. Where the ovals overlap, write the characteristics shared by both.



### Applying Economic Concepts

5. **Partnership** Make a list describing at least five character traits that you would want a business partner to possess in order to have a successful partnership with him or her.

### Critical Thinking Activity

6. **Categorizing Information** Imagine you are sole owner of an ice cream parlor. Make a spreadsheet listing all the daily and weekly duties you have to perform *in addition to* making ice cream.

# People & Perspectives



## John H. Johnson

ENTREPRENEUR (1918–)

- Began publishing *Negro Digest* in 1942
- Published first issue of *Ebony* in 1945
- Was one of the first entrepreneurs to recognize and take advantage of the tremendous business opportunities in the African American community
- Produces American Black Achievement Awards for television, first aired in 1978
- Launched *Ebony South Africa* in 1995

John Johnson began his career in 1942 at the age of 24. He used a \$500 loan on his mother's furniture to start *Negro Digest*, a magazine devoted to the accomplishments of African Americans. Today Johnson Publishing Company, Inc., is the world's largest African American-owned publishing company. This media empire includes *Ebony*, *Jet*, *Ebony Man*, and *Ebony South Africa* magazines and Johnson Publishing Company Book Division. Also part of the company are Fashion Fair Cosmetics and Supreme Beauty Products.

Like many minority-owned companies, Johnson faced many setbacks:

*“The first 25 years were difficult, trying to get circulation and to break through in advertising to get large companies to recognize that black consumers had money and would respond to advertising directed to them. The first 20 years or so in business, we couldn't get a bank loan.”*

Although the second 25 years have been easier, Johnson says African American startups will face many of the same hurdles he did:

*“But if you have the staying power and wherewithal, that is assuming you have a good product and market to sell to, you'll be successful. Never say never about new things.”*

Johnson has no plans to sell his company or take it public for the following reason:

*“If you go public, the stockholders, the board of directors, the SEC [Securities and Exchange Commission] are all your bosses and you've got to listen to them. We only have three board members: [daughter] Linda, her mother [Eunice Johnson], and I.”*

### Checking for Understanding

1. What products does Johnson provide?
2. Why does Johnson refuse to turn his business into a corporation?

# The Corporate World and Franchises

## COVER STORY

*BUSINESS WEEK, AUGUST 27, 2001*

John Bond runs the world's second most profitable bank. But no one will ever accuse the chairman of Britain's HSBC Holdings PLC of living it up at shareholders' expense....

HSBC's conservative strategy is paying off....[T]he 136-year-old bank [recently announced that] group pretax profit was \$5.4 billion, up 4% from the same period in 2000....

## READER'S GUIDE

### Terms to Know

- corporation
- stock
- limited liability
- articles of incorporation
- corporate charter
- common stock
- dividend
- preferred stock
- franchise

### Reading Objectives

1. What are the advantages and disadvantages of corporations?
2. How are corporations typically structured?
3. What types of businesses are involved in franchises?

**P**rofits are a good thing. As a sole proprietor, you keep all the profits. In a partnership, you share the profits with one or several partners. In a corporation, such as HSBC, the profits are dispersed among thousands of shareholders. So why do entrepreneurs incorporate? In this section, read to learn why and how corporations are formed.

## Why Form a Corporation?

Suppose your electronics repair business has grown. You now have several partners and have turned your garage into a

**corporation:** type of business organization owned by many people but treated by law as though it were a person; it can own property, pay taxes, make contracts, and so on

shop. You would like to expand and rent a store so that your business is more visible. You would also like to buy the latest equipment, charge a little less than your competitors, and capture a larger share of the market for electronics repair work. You need financial capital, however.

You have decided that you do not want any more partners. You would have to consult with them about every detail of the business as you do now with your present partners. What you want are financial backers who will let you use their funds while letting you run the business. What you are proposing is a corporation.

# Global Economy

## Big Business!

Many modern corporations are huge. A study conducted in the mid-1990s found that some of these corporations have bigger economies than the countries in which they operate! More than half of the world's 100 largest economies, the study revealed, were corporations, not nations. General Motors, the United States's largest corporation, had the 26th largest economy. This placed it above 167 nations, including Denmark, South Africa, Turkey, and Saudi Arabia. ■

## What Is a Corporation?

A **corporation** is an organization owned by many people but treated by law as though it were a person. A corporation can own property, pay taxes, make contracts, sue and be sued, and so on. It has a separate and distinct

existence from the stockholders who own the corporation's stock. **Stock** represents ownership rights to a certain portion of the future profits and assets of the company that issues the stock.

In terms of the amount of business done (measured in dollars), the corporation is the most significant type of business organization in the United States today. **Figure 8.5** on page 221 compares corporations to other forms of businesses in terms of numbers and proportion of total business revenue. You can see that although corporations make up only about 20 percent of all businesses, they earn about 90 percent of all business revenues.

Like sole proprietorships and partnerships, corporations have advantages as well as disadvantages. One of the major advantages of a corporation is **limited liability**. If a corporation goes bankrupt or is sued, only the business loses money and assets, not the stockholders. A major disadvantage of corporations is that they are taxed more heavily than other forms of business organizations. Look at **Figure 8.6** on page 222 to read about other advantages and disadvantages of corporations.

**stock:** share of ownership in a corporation that entitles the buyer to a certain part of the future profits and assets of the corporation

**limited liability:** requirement in which an owner's responsibility for a company's debts is limited to the size of the owner's investment in the firm

# Corporate Structure

In order to form a corporation, its founders must do three things. First, they must register their company with the government of the state in which it will be headquartered. Second, they must sell stock. Third, along with the other shareholders, they must elect a board of directors.

**Registering the Corporation** Every state has laws governing the formation of corporations, but most state laws are similar. Suppose that you and your partners decide to form a corporation. You will have to file the **articles of incorporation** with the state in which you will run your corporation. In general, these articles include four items:

- (1) Name, address, and purpose of the corporation;
  - (2) Names and addresses of the initial board of directors (these men and women will serve until the first stockholders' meeting, when a new board may be elected);
  - (3) Number of shares of stock to be issued;
  - (4) Amount of money capital to be raised through issuing stock.
- If the articles are in agreement with state law, the state will grant you a **corporate charter**—a license to operate from that state.

**articles of incorporation:** document listing basic information about a corporation that is filed with the state where the corporation will be headquartered

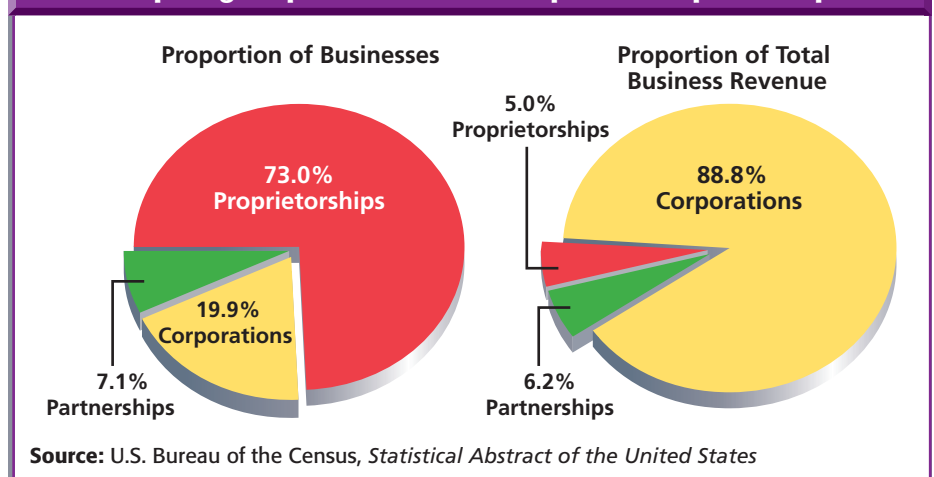
**corporate charter:** license to operate granted to a corporation by the state where it is established

**FIGURE 8.5**

## Business Organizations

Although proprietorships make up about 73 percent of American businesses, they generate only about 5 percent of total business revenues. *What percentage of American businesses are partnerships?*

### Comparing Corporations, Partnerships, and Proprietorships



For an online update of this graph, visit [ett.glencoe.com](http://ett.glencoe.com) and click on **Textbook Updates—Chapter 8**.

**CLICK HERE**



**FIGURE 8.6**

# Advantages and Disadvantages of Corporations

	Advantages	Disadvantages
<b>Profits and Losses</b>	<ul style="list-style-type: none"> <li>• Owners of the corporation—stockholders—do not have to devote time to the company to make money on their investment.</li> </ul>	
<b>Liability</b>	<ul style="list-style-type: none"> <li>• The corporation has limited liability.</li> <li>• If a corporation goes bankrupt or is sued, creditors cannot normally take personal property from stockholders to pay debts.</li> </ul>	
<b>Management</b>	<ul style="list-style-type: none"> <li>• Responsibility for running a corporation is divided among many.</li> <li>• Decisions are made by individuals trained in specific areas, such as sales, production, and so on.</li> <li>• Corporations can handle large and complicated operations, and can carry on many types of business activities at the same time.</li> </ul>	<ul style="list-style-type: none"> <li>• Decision making can be slow and complicated because so many levels of management are involved.</li> <li>• The interests of those running the corporation may not be the same as those of the stockholders, who often seek an immediate return on their investment.</li> </ul>
<b>Taxes</b>		<ul style="list-style-type: none"> <li>• The federal government and some state and local governments tax corporate profits.</li> <li>• The profits paid to stockholders as dividends are again taxed as income to those individuals.</li> </ul>
<b>Personal Satisfaction</b>	<ul style="list-style-type: none"> <li>• An individual may feel satisfaction simply in owning a part of a corporation.</li> </ul>	<ul style="list-style-type: none"> <li>• Most individual stockholders have little or no say in how a corporation is run.</li> </ul>
<b>Financing Growth</b>	<ul style="list-style-type: none"> <li>• Corporations draw on resources of investors and may issue stock at any time to raise capital.</li> </ul>	
<b>Life of the Business</b>	<ul style="list-style-type: none"> <li>• A corporation can continue indefinitely if it remains profitable.</li> </ul>	



**Selling Stock** To raise funds for the expansion of your electronics repair business, you could sell shares of either common or preferred stock in your new corporation. **Common stock** gives the investor part ownership in the corporation, a right to a percentage of the company's future profits, and voting rights at the annual stockholders' meeting. However, it does not *guarantee* a **dividend**—a money return on the money invested in a company's stock. Holders of **preferred stock** do not have voting rights in the corporation, but they are guaranteed a certain amount of dividend each year. Plus, if the corporation goes out of business, holders of preferred stock have first claim on whatever value is left in the company after creditors have been paid.

If your corporation were to become large, you might find its stock traded in the local over-the-counter market. *Over-the-counter* means that individual brokerage firms hold quantities of shares of stock that they buy and sell for investors. Should your corporation continue to grow, its stocks may be traded on a stock exchange.

**common stock:** shares of ownership in a corporation that give stockholders voting rights and a portion of future profits (after holders of preferred stock are paid)

**dividend:** portion of a corporation's profits paid to its stockholders

**preferred stock:** shares of ownership in a corporation that give stockholders a portion of future profits (before any profits go to holders of common stock), but no voting rights

**Naming a Board of Directors** To become incorporated, a company must have a board of directors. You and your partners, as founders of the corporation, would select the first board for your corporation. After that, stockholders at their annual stockholders' meetings would elect the board. The bylaws of the corporation govern this election. Bylaws are a set of rules describing how stock will be sold and dividends paid, with a list of the duties of the company's officers. They are written after the corporate charter has been granted.

**Economic Connection to...**

**History**

## Franchises, Franchises, Everywhere!

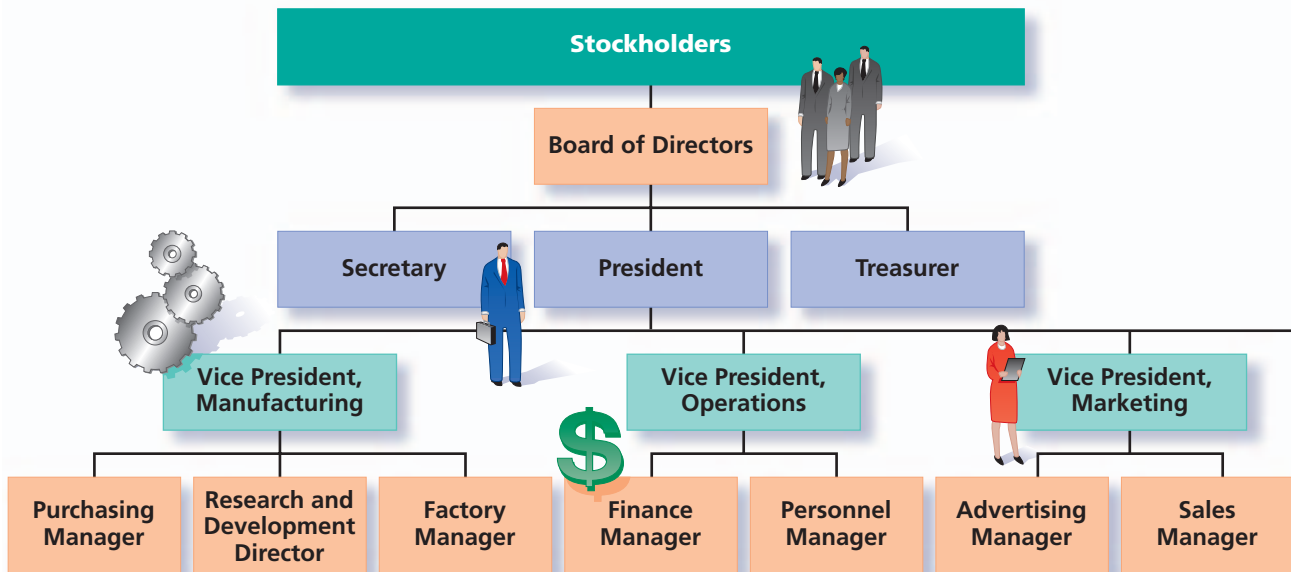
**T**he inventor and entrepreneur Isaac Singer began the practice of franchising in the United States. In the mid-1800s, Singer signed agreements with several merchants that allowed them to market his sewing machines.

The interstate highway system caused the practice of franchising to explode in the

1950s. Increasing automobile ownership took more Americans on the road, where they looked for familiar motels, restaurants, and gas stations they knew and trusted. Today, franchising accounts for more than 40 percent of all U.S. retail sales. Analysts estimate that franchising employs more than 8 million people in the United States. ■

**FIGURE 8.7**

**Corporate Chain of Command** A typical board of directors hires officers to run the company. *In this organizational chart, who reports to the vice president of manufacturing?*

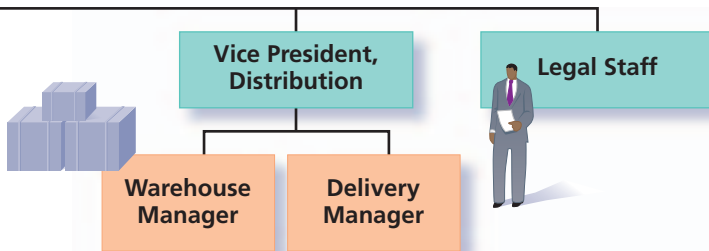


The board is responsible for supervising and controlling the corporation. It does not run business operations on a day-to-day basis. Instead, it hires officers for the company—president, vice president(s), secretary, and treasurer—to run the business and hire other employees. **Figure 8.7** shows the typical structure of a corporation.

## Franchises

Many hotel, motel, gas station, and fast-food chains are franchises. A **franchise** is a contract in which a franchiser sells to another business the right to use its name and sell its products. The person or business buying these rights, called the franchisee, pays a fee that may include a percentage of all money taken in. If a person buys a motel franchise, for example, that person agrees to pay the motel chain a certain fee plus a portion of the profits for as long as his or her motel stays in business. In return, the chain will help the franchisee set up the motel. Often, the chain will have a training program to teach the franchisee about the business and set the standards of business operations.

**franchise:** contract in which one business (the franchiser) sells to another business (the franchisee) the right to use the franchiser's name and sell its products



Practice and assess key skills with *Skillbuilder Interactive Workbook, Level 2.*

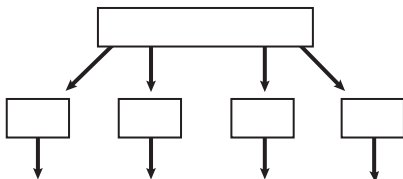
## SECTION 3 Assessment

### Understanding Key Terms

- 1. Define** corporation, stock, limited liability, articles of incorporation, corporate charter, common stock, dividend, preferred stock, franchise.

### Reviewing Objectives

- 2.** Analyze the advantages and disadvantages of corporations.
- 3. Graphic Organizer** Create a diagram like the one below to show how corporations are typically structured.



- 4.** What types of businesses are involved in franchises?

### Applying Economic Concepts

- 5. Franchises** In what industry would you franchise if offered the opportunity? Explain the possible advantages and help available from other franchises in the same industry. Then describe possible disadvantages of setting up a franchise in your chosen industry.

### Critical Thinking Activity

- 6. Making Comparisons** Look in the financial pages of a recent newspaper to analyze how the stocks of three corporations have performed. What was the closing price for each? What were their 52-week highs? *For help in reading the financial page, see page xxiii in the Economic Handbook.*

## SPOTLIGHT ON THE ECONOMY

### Hate to Eat and Fly, but . . .

**Check It Out!** In this chapter you learned about franchises and corporations. In the following article, read to learn how one franchise has expanded its service in an unusual way.

Now that the drive-through window is a fixture of the fast-food world, Burger King is perfecting the fly-through. A Burger King in suburban London dubs the addition to its regular restaurant the “Whopper Chopper,” a landing pad where helicopter pilots can drop in, grab some grub, and fly out without leaving the cockpit.

Pilots call first to alert Burger King that they are landing. An employee dashes out and calls the order in. Then it is delivered to the waiting chopper. “This is more like the old diners

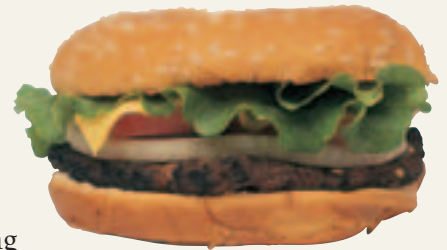
where someone comes out to take your order,” says Jon Clarke, a Burger King spokesperson in London. “It’s a bit more personal.”

Pilots agree. “I think this is a great idea,” says Mark Barry-Jackson, an Aeromega pilot. “Finding suitable places to stop and refuel passengers has always been difficult.” The landing pad, which is under a helicopter traffic lane, was so popular

it was closed over the holidays so it could be made big enough to handle military choppers, whose pilots had heard about the place.

Burger King, still testing the concept, won’t comment on its profitability. But the fly-through is an idea that may just take off.

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#### Think About It

1. How does this Burger King franchise accommodate customers who are helicopter pilots?
2. What do you think is positive about franchises in general? Negative?



## ECONOMICS Online



CLICK HERE

**Chapter Overview** Visit the *Economics Today and Tomorrow* Web site at [ett.glencoe.com](http://ett.glencoe.com) and click on **Chapter 8—Chapter Overviews** to review chapter information.

- The biggest disadvantage is that the proprietor has **unlimited liability** and can lose personal **assets** as well as the business.
- A **partnership** is a business organization owned by two or more individuals.
- A legally binding partnership agreement describes the duties of each partner, the division of profits, and the distribution of assets should the partnership end.
- In a **limited partnership**, one general partner assumes the management duties and debt responsibility, while the limited partners contribute money but have no liability.

### SECTION 1 Starting a Business

- People usually decide to start a business to gain profits, to “do something on their own,” or to be their own boss.
- **Entrepreneurs** must gather the relevant factors of production and decide on the form of business organization that best suits their purposes.
- For those wanting to start a small business, help is available from the government and from the Internet.
- Every business must consider four basic elements: expenses, advertising, **receipts** and record keeping, and risk.

### SECTION 2 Sole Proprietorships and Partnerships

- The most basic type of business organization is the **sole proprietorship**, a business owned by one person.
- The biggest advantages of sole proprietorships are that the proprietor has full pride in owning the business and receives all the profits.

### SECTION 3 The Corporate World and Franchises

- A **corporation** can own property, pay taxes, make contracts, and sue and be sued.
- One of the major advantages of a corporation is **limited liability**.
- A major disadvantage is that corporations are taxed more heavily than other forms of business organizations.
- To form a corporation, its founders must register with the state government, sell **stock**, and elect a board of directors.
- A **franchise** is a contract in which a franchiser sells to another business the right to use its name and sell its products.

# Assessment and Activities

## ECONOMICS Online



**Self-Check Quiz** Visit the *Economics Today and Tomorrow* Web site at [ett.glencoe.com](http://ett.glencoe.com) and click on **Chapter 8—Self-Check Quizzes** to prepare for the Chapter Test.

**CLICK HERE**

## Identifying Key Terms

Identify the letter of the definition in Column B that correctly defines each term in Column A.

### Column A

1. inventory
2. corporate charter
3. assets
4. franchise
5. unlimited liability
6. sole proprietorship
7. partnership
8. stock
9. joint venture
10. corporation

### Column B

- a. items of value
- b. business owned by two or more people
- c. supply of items that are used in business
- d. business owned by many people, but treated as a person itself
- e. contract in which a business sells the right to use its name to another business

- f. business owned by one person
- g. right to operate
- h. temporary partnership
- i. ownership shares in a business
- j. legal responsibility for all debts incurred when doing business

## Recalling Facts and Ideas

### Section 1

1. Every business involves expenses and receipts and record keeping. What are two other elements?
2. When you calculate your profits, it is especially important for you to include the value of your time. What is this called?
3. If you need help in starting a small business, where can you look?

### Section 2

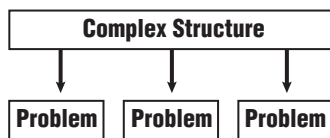
4. What is the most common form of business organization?
5. Analyze the disadvantages of a sole proprietorship.
6. Explain the characteristics of a partnership and a limited partnership.
7. What is the difference between a limited partnership and a joint venture?

### Section 3

8. Explain the characteristics of a corporation.
9. Who grants corporate charters?
10. Which group within a corporation chooses the board of directors?
11. How does a franchise operate?

## Thinking Critically

- 1. Drawing Inferences** Why do you have to include the opportunity cost of your time when you calculate your profits in your own business?
- 2. Drawing Conclusions** Why would a person decide in favor of a partnership rather than a sole proprietorship?
- 3. Understanding Cause and Effect** Create a diagram like the one below and identify three problems in a corporation that might be caused by its complex organizational structure.



## Applying Economic Concepts

**Economic Institutions and Incentives** In this chapter you have read about numerous advantages and disadvantages of different types of business organizations. Make a list of the following: sole proprietorship, partnership, limited partnership, joint venture, corporation, and franchise. After each type, indicate the single most important advantage that you believe this form of business organization has.

## Technology Activity



**Developing Multimedia Presentations** Think of a product or service you would like to produce. Create a multimedia presentation promoting that product or service. Utilize video, graphics, and music in your presentation. Share your presentation with the rest of the class.

## Reviewing Skills

**Using the Internet** Several business news magazines—*Forbes*, *Fortune*, and *Business Week*—report the top several hundred corporations in America every year. Find out what the top five corporations are, then use the Internet to locate each company's home page. Once you have located each site, access them and use the information to prepare an oral report on each company's (1) number of employees, (2) total sales in billions of dollars, (3) total market value as given by the stock market, and (4) change in ranking from the previous year.

## Cooperative Learning Project

Working in groups of four, select a corporation listed in the financial pages of a newspaper. Then use business magazines and financial and annual reports, if possible, to determine the annual earnings, dividends, and stock prices of that corporation over the past year. Compare the corporation with those selected by other groups and discuss which stocks would have been the best investments during the past year.



Notice the labels on your clothes, shoes, and food. Find out in which countries these items were made or produced. Then research one of the top five corporations within one of those countries. Is its corporate structure similar to the structure found in American corporations? Explain.



# Economics Lab

## *Setting Up a Business*

From the classroom of Denny C. Jackson, Switzerland County High School, Vevay, Indiana

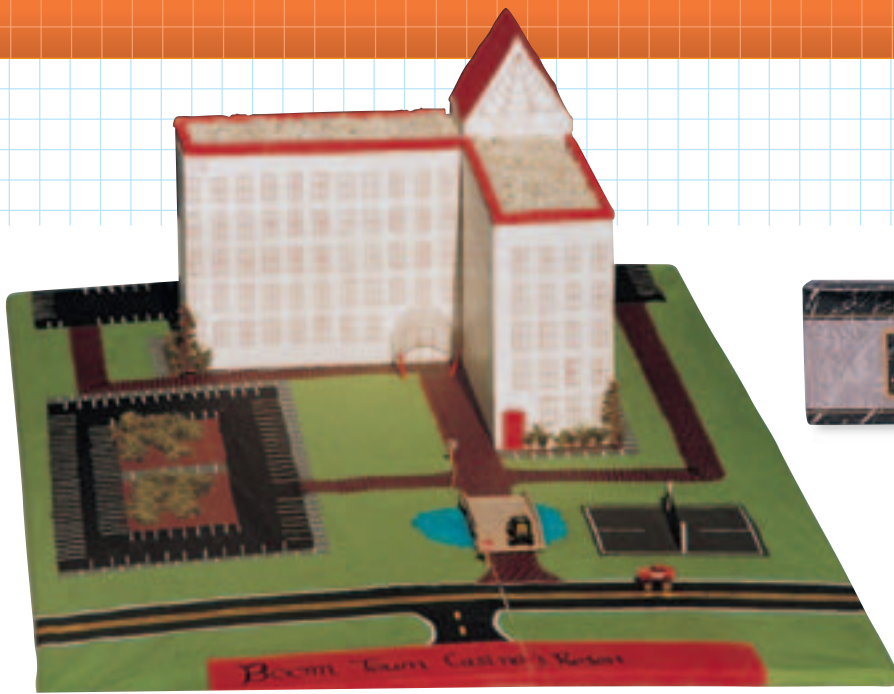
**I**n Chapter 8 you learned about the different types of business organizations and what it takes to start a business. In this lab, you will set up a hotel business.

### **STEP A Tools Needed**

- ✓ Hotel directories
- ✓ Hotel franchise circulars
- ✓ Vacation/travel guides (for location of the hotel)
- ✓ Drawing paper
- ✓ Colored pencils
- ✓ Clear plastic folder
- ✓ Computer with access to the Internet (optional)
- ✓ Supplies necessary to build a scale model of your hotel

### **STEP B Procedures to Follow**

- 1.** Work with a partner to research points 2 through 9.
- 2.** Determine the location of your hotel. Use travel guides to identify the “generators” that will draw people to your hotel: national park, theme park, university, airport, isolated interstate, tour groups, and so on.
- 3.** Decide whether your hotel should be an independent or a franchise. Explain your choice.
- 4.** Determine the makeup of the hotel. How many rooms? Restaurant and lounge? Swimming pool? Gift shop? Game room and health spa?



5. Decide on the number and wages of employees you will need for all shifts: a manager, assistant managers, front desk clerks, housekeeping staff, maintenance staff, restaurant staff, and so on.
6. Decide the layout of the rooms as well as their décor. Also design the exterior of the hotel, including parking facilities, subway access, and so on.
7. Determine what you will charge per room. Report on what items are included in the room (shampoo, coffee maker, satellite TV, and so on).
8. Identify and evaluate local ordinances and regulations pertaining to the establishment of the hotel.
9. Determine how you will obtain the funds needed to begin: banking institution, grant or loan from a small business incubator, etc.

### STEP C Creating an Economic Model

Use the results of your research to create at least two drawings: one showing the layout of the rooms, and one showing the exterior of the hotel. Then create a scale model of your hotel. Present your drawings and model to the rest of the class.

### STEP D Lab Report Analysis

After completing your presentation, answer the following questions:

1. Why did you choose an independent or franchise?
2. Why did you choose the specific location of your hotel?
3. How did you arrive at the room rate?
4. What did you decide to include in the total project?