

Entrepreneurial Management

Chapter 8

The Organizational Plan: Teams, Legal Structures, Alliances

Lecturer: Dr. Michaella DeLeon Castillo
Philippines

After studying this chapter, you should be able to...

1. Describe the characteristics and value of a strong management team.
2. Explain the common legal forms of organization used by small businesses.
3. Identify factors to consider in choosing among the primary legal forms of organization.
4. Discuss the unique features and restrictions of five specialized organizational forms.
5. Understand the nature of strategic alliances and their uses in small businesses.
6. Describe the effective use of boards of directors and advisors.



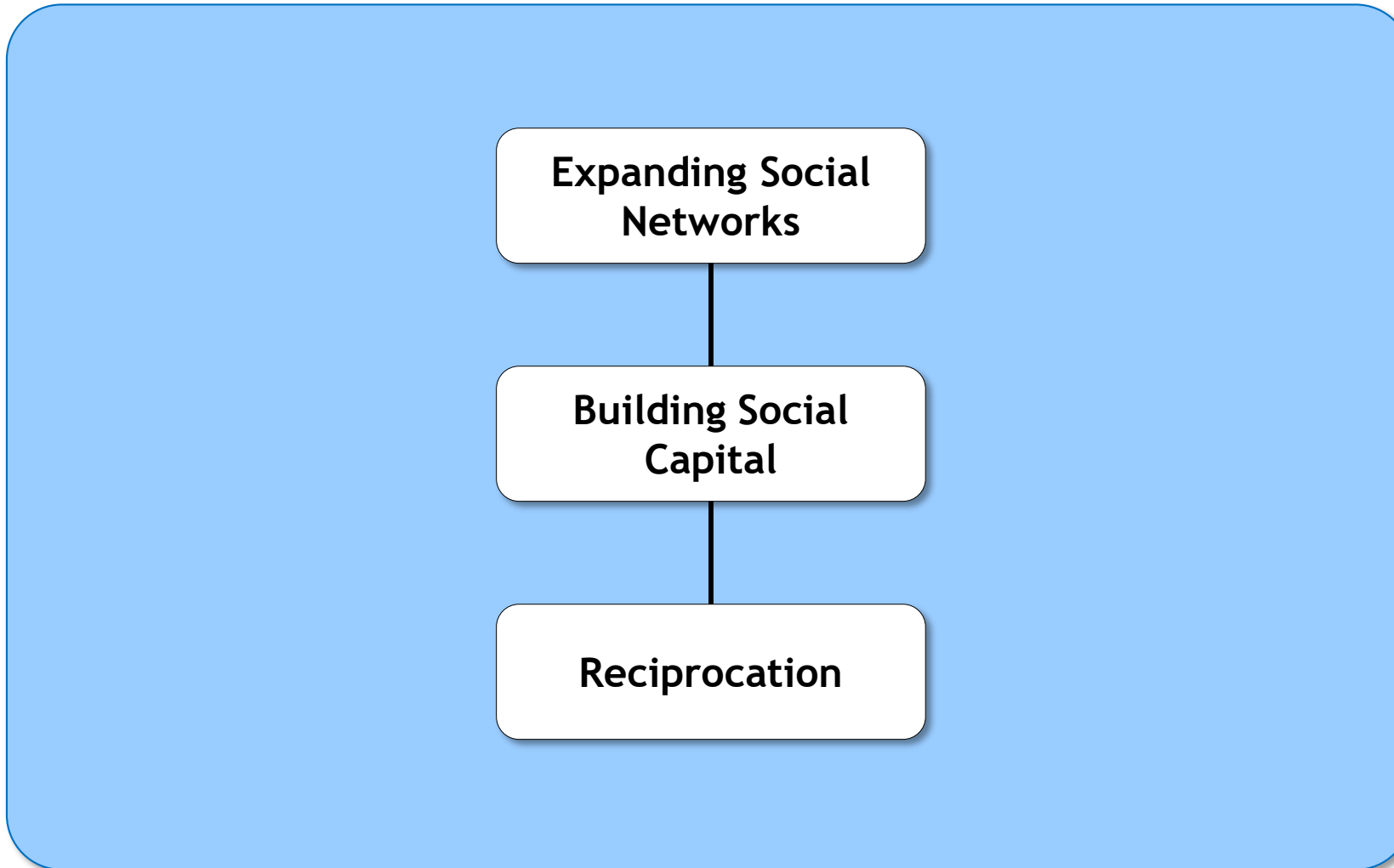
Building a Management Team

- Management Team
 - Managers and other key persons who give an organization its general direction
- Characteristics of a Strong Management Team
 - Capable of securing the resources needed to make business a success
 - Reassures investors about the their investment and the continuity of business
 - Diversity of talent makes the team stronger than an individual entrepreneur

Building a Management Team (cont'd)

- Team Building and Structure
 - The required combination of education and experience depends on the type of business and the nature of its operations
 - The key: achieving a balance of skills and competencies in functional areas
 - Designing an internal management structure that defines relationships and responsibilities
 - ❖ Outside professional support can supplement the skills of a management team
 - ❖ An active board of directors can provide counsel and guidance.

Building Relationships



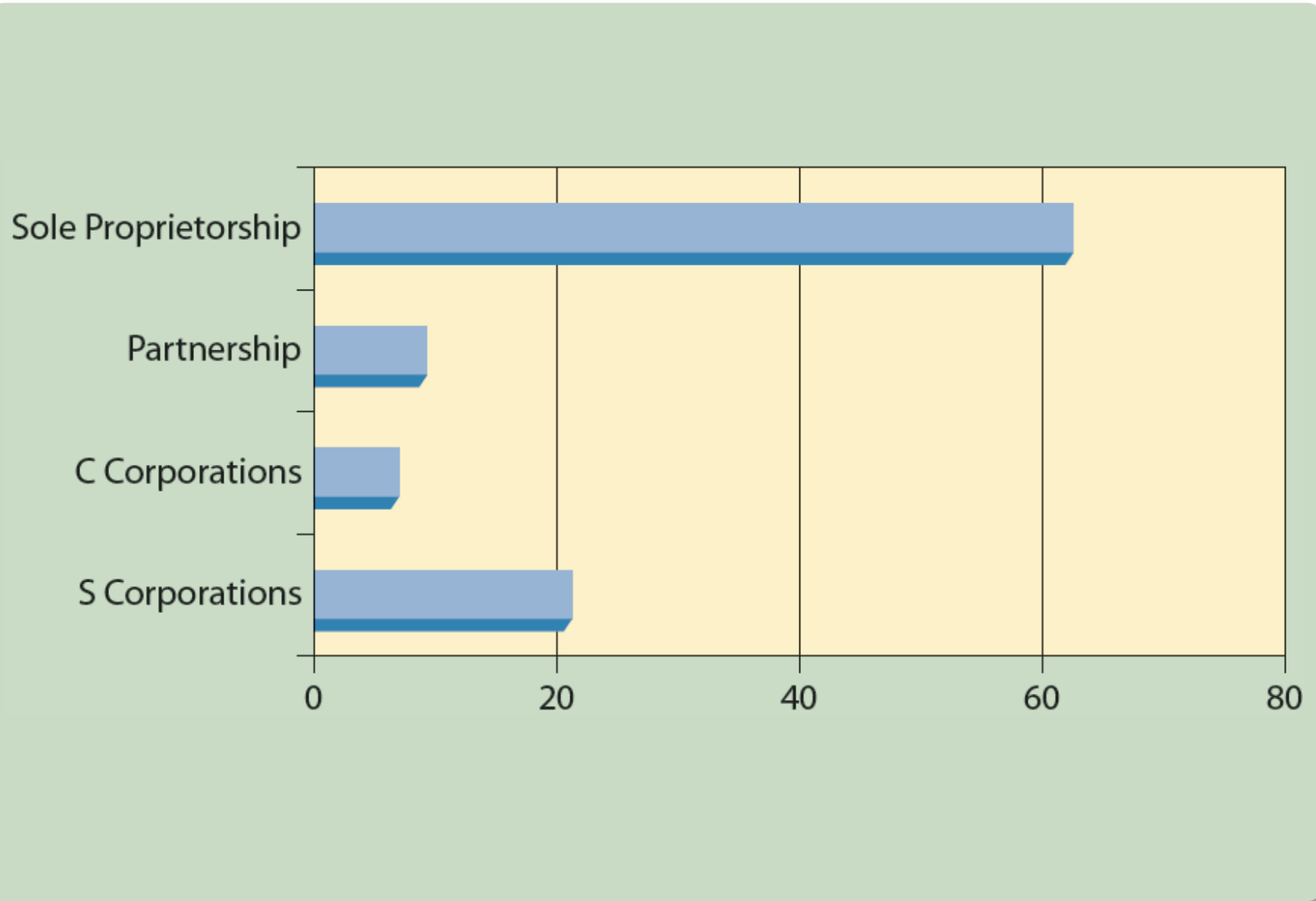


8.1

Forms of Legal Organization for Small Businesses



8.2 Percentage of Small Businesses by Legal Form of Organization



The Sole Proprietorship Option

- Sole Proprietorship

- A business owned by one person, who bears unlimited liability for the enterprise.

- Advantages

- Receives all of the firm's profits.
- Holds title to all of the firm's assets.
- Can easily sell or transfer ownership of the company name and assets.
- Requires no registration or filing fee.
- Has absolute freedom from interference by other stakeholders.

The Sole Proprietorship Option (cont'd)

- Disadvantages

- Bears all business risk.
- Is subject to all claims of creditors.
- Has unlimited personal liability for business.
- Receives no tax free benefits as an employee.
- Death/incapacity of owner terminates business.
- Is limited to the proprietor's personal capital.
- Is taxed on business income as personal income.

The Partnership Option

- Partnership

- A legal entity formed by two or more co-owners to carry on a business for profit.

- Partner Qualifications

- Required: of legal age to contract
- Desired: Honest, healthy, capable, and compatible

The Partnership Option

- Questions about Partnership Formation
 - What is our business concept?
 - How are we going to structure ownership?
 - Why do we need each other?
 - How do our lifestyles differ?

Partnership Insights

- Choose your partner carefully.
- Be open, but cautious, about partnerships with friends.
- Test-drive the relationship, if possible.
- Create a combined vision for the business.
- Prepare for the worst.



Rights and Duties of Partners

- Partnership Agreement
 - A document that states explicitly the rights and duties of partners.
- Joint and Several Liability
 - The liability of each partner resulting from any one partner's ability to legally bind the other partners.
- Termination of a Partnership
 - Provisions for rapidly responding to death or departure of a partner.



The C Corporation Option

- Corporation

- A business organization that exists as a legal entity and provides limited liability for its owners.

- Legal Entity

- A business organization recognized by the law as having a separate legal existence (“artificial being”); can be sued, hold property, and incur debt.

- The C Corporation

- An ordinary, or regular, corporation chartered by the state and taxed by the federal government as a separate legal entity.

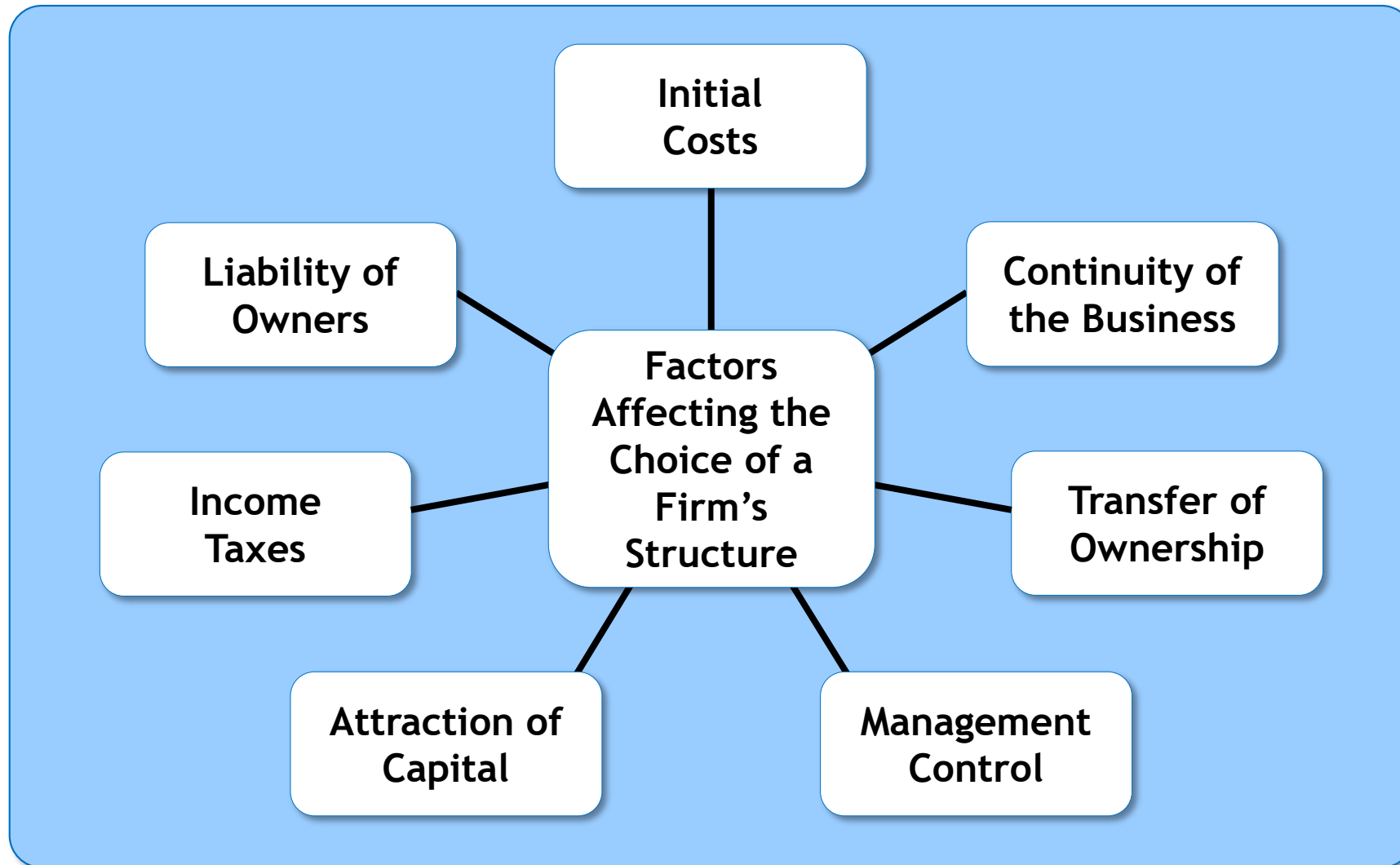
The Corporate Charter: Articles of Incorporation

- Name of company
- Formal statement of formation
- Type of Business
- Location
- Duration
- Classes and preferences of stock
- Number and par value of authorized shares
- Voting privileges for each class of stock
- Names of incorporators and directors
- Capital stockholders
- Statement of limited liability for stockholders
- Statement of directors' powers

Rights and Status of Stockholders

- **Stock Certificate**
 - A document specifying the number of shares of stock owned by a shareholder.
- **Pre-emptive Right**
 - The right of current stockholders to buy new shares of stock before they are offered to the public.
- **Legal Status**
 - Ownership provides control over the firm.
 - Ownership limits liability to investment in the firm.
 - Ownership can be transferred without affecting the firm's operations.

Criteria for Choosing an Organizational Form



8.3 Comparison of Basic Legal Forms of Organization

Form of Organization	Initial Organizational Requirements and Costs	Liability of Owners	Continuity of Business
Sole proprietorship	Minimum requirements; generally no registration or filing fee	Unlimited liability	Dissolved upon proprietor's death
General partnership	Minimum requirements; generally no registration or filing fee; written partnership agreement not legally required but strongly suggested	Unlimited liability	Unless partnership agreement specifies differently, dissolved upon withdrawal or death of partner
C corporation	Most expensive and greatest requirements; filing fees; compliance with state regulations for corporations	Liability limited to investment in company	Continuity of business unaffected by shareholder withdrawal or death
Form of organization preferred	Proprietorship or partnership	C corporation	C corporation

8.3 Comparison of Basic Legal Forms of Organization (continued)

Transferability of Ownership	Management Control	Attractiveness for Raising Capital	Income Taxes
May transfer ownership of company name and assets	Absolute management freedom	Limited to proprietor's personal capital	Income from the business is taxed as personal income to the proprietor
Requires the consent of all partners	Majority vote of partners required for control	Limited to partners' ability and desire to contribute capital	Income from the business is taxed as personal income to the partners
Is easily transferred by transferring shares of stock	Shareholders have final control, but usually board of directors controls company policies	Usually the most attractive form for raising capital	The C corporation is taxed on its income and the stockholder is taxed if and when dividends are received
Depends on the circumstances	Depends on the circumstances	C corporation	Depends on the circumstances

Forms of Business—Federal Income Taxes

- Sole Proprietorship

- Self-employed persons are taxed on their business incomes at tax rates set for individuals.

- Partnership

- The partnership does not pay taxes; allocated shares of income from partnership are taxed as personal income for each of the partners.

- Corporation

- As a separate legal entity, it reports its income and pays any taxes related to its profits; dividends paid to shareholders are taxed as personal income.

Liability of Owners

- Piercing the Corporate Veil

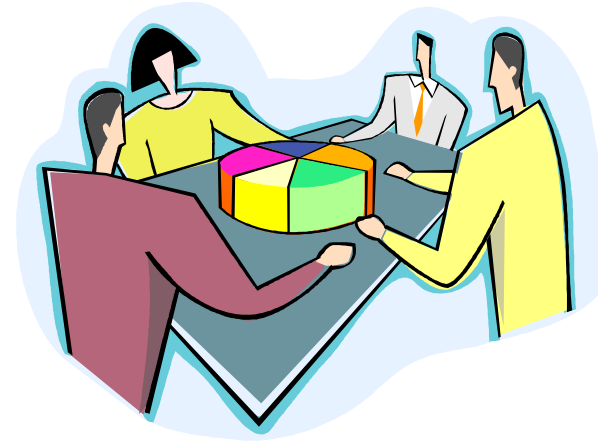
- A situation in which the courts conclude that incorporation has been used to perpetuate a fraud, skirt a law, or commit some wrongful act, and thus remove liability protections from the corporate entity.

- Agency Principle

- An employer is liable for the actions of an employee while on company business.
- Organizing as a corporation or limited liability company shields the personal assets of owners in agency cases.

Specialized Forms of Organization

- The Limited Partnership
 - General partner
 - ❖ Active in the business, personally liable for the debts of the business
 - Limited partners
 - ❖ Not active in the business, liability limited to investment in business
 - Income (taxable) or losses
 - ❖ Apportioned to each partner



Specialized Forms... (cont'd)

- S (or Subchapter S) Corporation
 - Eligibility Requirements
 - ❖ No more than 100 stockholders
 - ❖ All stockholders must be individuals, estates, or trusts
 - ❖ Only one class of stock can be outstanding
 - ❖ Must operate on a fiscal calendar year basis
 - ❖ No nonresident alien stockholders
 - Benefits
 - ❖ Liability limited to investment in corporation
 - ❖ Passes taxable income or losses to share holders

Specialized Forms... (cont'd)

- The Limited Liability Company

- Stockholders have limited liability but pay personal income taxes on the business profits.
 - ❖ Easier to set up
 - ❖ More flexible
 - ❖ Tax advantages

Specialized Forms... (cont'd)

- The Professional Corporation
 - Protects licensed professionals from liability of partners but not their personal liability.
- The Nonprofit Corporation
 - Serves civic, educational, charitable, or religious purposes but not for generation of profits.

Forming Strategic Alliances

- Strategic Alliances

- An organizational relationship that links two or more independent business entities in a common endeavor

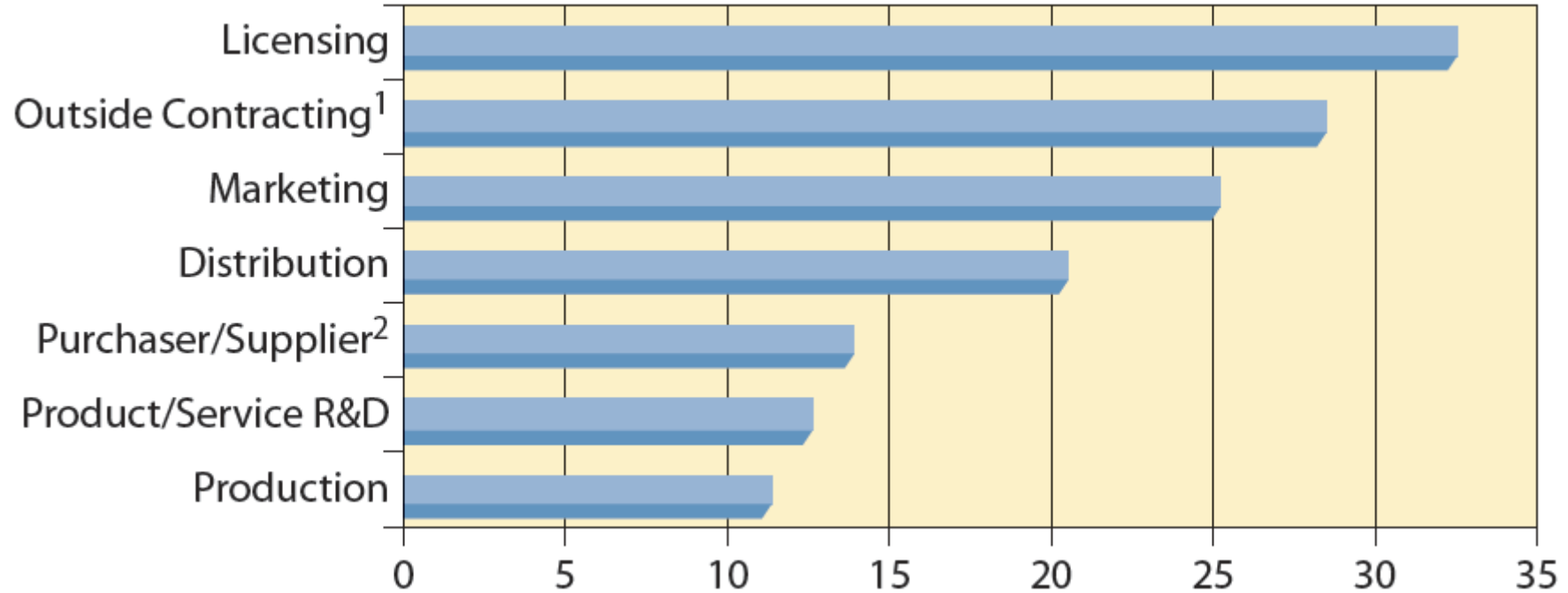
- Benefits

- ❖ Reduced cycle times through shared resources
- ❖ Increased performance through synergistic combinations of financial resources and creativity

- Risk

- ❖ Difficulty in establishing and maintaining alliances

Most Popular Small Business Alliances by Type



Setting Up and Maintaining Successful Strategic Alliances

- Steps in Building Strategic Alliances
 - Establish a healthy network of contacts.
 - Identify and contact individuals within a firm who are likely to return your call.
 - Outline the partner's potential financial benefits from the alliance (clearly a win–win opportunity).
 - Learn to speak and understand the “language” of your partner.
 - Continue to monitor the progress of the alliance.

Making the Most of a Board of Directors

- Board of Directors
 - The governing body of a corporation, elected by the stockholders
 - ❖ Inside directors work for the firm
 - ❖ Outside directors do not work for the firm
- Duties of Directors
 - Elect the firm's officers (top management)
 - Approve top management's strategic plans and policies
 - Review top management's performance
 - Declare dividends

The Board of Directors

- Contributions of Board of Directors

- Bring knowledge and experience

- ❖ Review policy decisions
- ❖ Provide general direction
- ❖ Monitor the firm's ethical behavior
- ❖ Mediate and resolve disputes among top management

- Alternative: An Advisory Council

- Provides advice but does not have the fiduciary responsibility for the direction of the firm.
- May be less threatening and more cooperative than a board of directors

Key Terms

advisory board

board of directors

C corporation

corporate charter

corporation

general partner

joint and several liability

legal entity

limited liability company

limited partner

limited partnership

management team

nonprofit corporation

organizational test

partnership agreement

partnership

piercing the corporate veil

pre-emptive right

professional corporation

reciprocation

S corporation (Subchapter S corporation)

social capital

social network

sole proprietorship

stock certificate

strategic alliance

unlimited liability