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4 Entrepreneurship, Small Business, and New Venture Creation

CBC TV

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

LO1 List the traits of an effective entrepreneur, and describe how these characteristics often lead to business success. (pp. 66–70)

LO2 Describe the factors that lead to small business failure, and explain why a business plan is crucial to small business success. (pp. 70–73)

LO3 Compare the advantages and disadvantages of starting a business from scratch to buying an existing business. (pp. 73–75)

LO4 Outline the advantages and disadvantages of franchising. (pp. 75–79)

LO5 Summarize the potential benefits and drawbacks of each major source of small business financing. (pp. 79–80)

LO6 Explain the advantages and disadvantages of sole proprietorship. (pp. 80–82)

LO7 Explain the advantages and disadvantages of partnership and describe the importance of partnership agreements. (pp. 82–84)

LO8 Explain how a corporation is formed and how it compares with sole proprietorships and partnerships. (pp. 84–85)

LO9 Describe the characteristics of nonprofit corporations and cooperatives. (pp. 86–87)

LO10 Summarize the different types of mergers and acquisitions and explain why they occur. (pp. 87–88)

OPENING DISCUSSION: STARTING A NEW BUSINESS

It's often said that necessity is the mother of all invention, and Lee Renshaw brings this sentiment to life. While he was studying industrial design at Humber College, Renshaw lived an hour away in Kitchener, Ontario. As a result, he spent the majority of his school nights couch-surfing with friends and living out of a duffel bag: "It was a nightmare—my clothes were literally in a huge ball all the time. I wanted some way not to look like I was living out of a laundry basket," he says. From this aversion to wrinkled trousers arose Rise and Hang Travel Gear, his organizational travel gear line. In other words, a better kind of luggage.

Rise and Hang Travel Gear rose to fame on a 2013 episode of CBC's *Dragons' Den*. Clad in nothing but their fluorescent underwear, Lee and brother/co-owner Sean demonstrated their product's ability to keep clothing clean and neat by taking clothes out of the Rise and Hang and dressing neatly in front of the panel. After catching the Dragons' attention, it was up to Lee's presentation skills to seal the deal. The brothers ended up securing $100 000 for a 50 percent stake in their company with Arlene Dickinson and David Chilton.

Before starting Rise and Hang Travel Gear, Lee developed many skills and abilities both through part-time jobs and as a college student that he says helped him to refine Rise and Hang both as a company and a product. "I got a tonne of experience communicating my ideas and receiving positive and negative feedback . . . and then being able to use it constructively. Everyone has an opinion, but the trick is to be able to sort out what is useful and what is not. I like getting negative feedback because it means that I . . . might gain an insight that my competitors don't know about. [Using this skill, I] did a lot of market research to determine what our customers liked and didn't like and used that knowledge to develop our product line."

To begin, he and Sean wrote a business plan, but he stresses the importance of its adaptability. "A business plan is good to figure out that the basics are in check when starting. After that, all you really have is assumptions until you get real data." Initially, they had intended to market Rise and Hang to the retail mass market on their own, but realizing the need for publicity they changed their plan quickly. Part of his grander plan was choosing a perfectly matched partner in brother Sean. Optimistic Lee had the design and sales skills, while his more realistic brother was a pro at project management. "While we have different strengths and weaknesses, at the core we share the same vision for our brand and keep each other accountable." They complement one another, as all great partners do.

His top advice for budding entrepreneurs? Start young. You need lots of time to build a business. He also explains that even if, like him, your product may be more innovative than the standard Adidas hold-all, this alone won't make it more popular. "Without sales, you have no business, no matter how good your 'mousetrap' is. Anything you do in life comes down to being able to sell." If you can't sell, hire somebody who can. Luckily, the Renshaw brothers hit the mark dead on: not only a good mousetrap, but "Don Drapers" in the *Dragons' Den*, too.[1]

DISCUSSION QUESTIONS

1. Lee mentioned that the experience he gained from past jobs and what he learned at college helps him in his business. What experiences do you have or what are you learning in school that you think could help you be successful in business?
2. What do you think are some of the biggest advantages and disadvantages of working with a partner?
3. What types of issues do you think Lee and Sean have had to deal with to start and grow their business?

ENTREPRENEURSHIP: WHAT'S IN IT FOR ME?

LO1 List the traits of an effective entrepreneur, and describe how these characteristics often lead to business success.

The Traits of Successful Entrepreneurs

What is an entrepreneur? We've all heard of Starbucks, Nike, and Microsoft, but you probably don't associate these big-name companies with small business. But at one point, each of these companies was a small business started by **entrepreneurs**—people who assume the risk of creating, organizing, and operating a business. Not all small businesses are entrepreneurial. What makes a new venture entrepreneurial is that the idea behind the business is innovative or change oriented. Entrepreneurs most often start a business to satisfy an **opportunity niche**—a need in the marketplace that is not being adequately fulfilled.

entrepreneur Someone who assumes the risk of creating, organizing, and operating a business and who directs all the business resources.

opportunity niche A need in the marketplace that is not being adequately fulfilled.

The brothers who started McDonald's spotted an opportunity niche. Realizing that the hamburger was the bestseller in their California restaurant, they created an assembly line that allowed them to produce burgers quickly and inexpensively, and business boomed. It expanded even more when Ray Kroc, who was selling milkshake machines in California, convinced the brothers not only to use his milkshake machines but also to let him open another McDonald's restaurant in Chicago. Seeing the opportunity niche in fast food, Kroc later bought the McDonald's restaurants from the McDonald brothers. The company now operates more than 32 000 restaurants in 117 countries, generating more than US$20 billion in revenue annually.[2]

Video: New Toy Company Inspires Little Girls to Build Houses

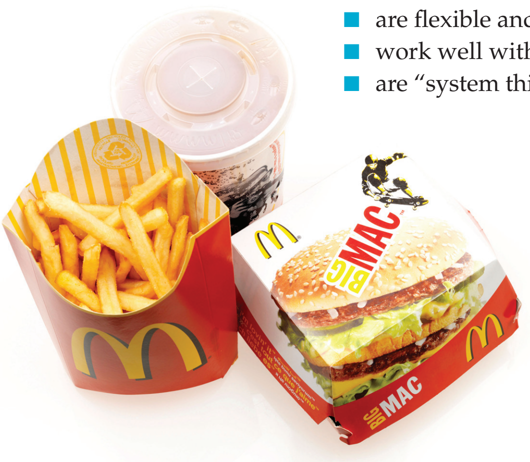
What are the traits of successful entrepreneurs? Wayne Huizenga started Waste Management Inc., now a leader in the waste and environmental services industry, by buying a single garbage truck in 1968. He expanded the company by buying other trash collection services, and by 1983 the company had grown into the largest of its kind in the United States. But Huizenga didn't stop there. He also started Blockbuster Video, as well as AutoNation, the behemoth automotive dealer.[3] How can some entrepreneurs like Huizenga begin many successful businesses while others have a difficult time getting their ideas off the ground? How do successful entrepreneurs see an opportunity niche and know exactly what they need to do to seize the opportunity and succeed?

Although luck and timing play a large role in entrepreneurial success, research has also shown that successful entrepreneurs

- are innovative
- take risks
- are motivated to succeed
- are flexible and self-directed
- work well with others and possess good leadership skills
- are "system thinkers," seeing the whole process rather than just individual pieces of it

Video: Fruit Breeder Invents Cotton Candy Flavoured Grapes

Video: Convertible Heels: Shoe Transforms for Day, Night



Whitebox media/Mediablitzimages/Alamy

All businesses have to start somewhere. Even McDonald's, which is one of the biggest businesses in the world today, started out as just a single restaurant in California.

How are entrepreneurs innovative? Successful entrepreneurs see problems to be solved or opportunities that aren't being addressed in the marketplace—they recognize opportunity niches. They also make improvements to existing products or systems, or they introduce something new and make profitable solutions out of problems. Renowned management and business thinker Peter Drucker noted that successful entrepreneurs "exploit change as an opportunity for a different business or a different service."[4] For example, Henry Ford did not invent the automobile—he just found a better way to build them. His improvement was not only in creating a new machine (the Model T), but also in developing an assembly line process by which his company could make multiple automobiles more efficiently, allowing Ford to dramatically lower

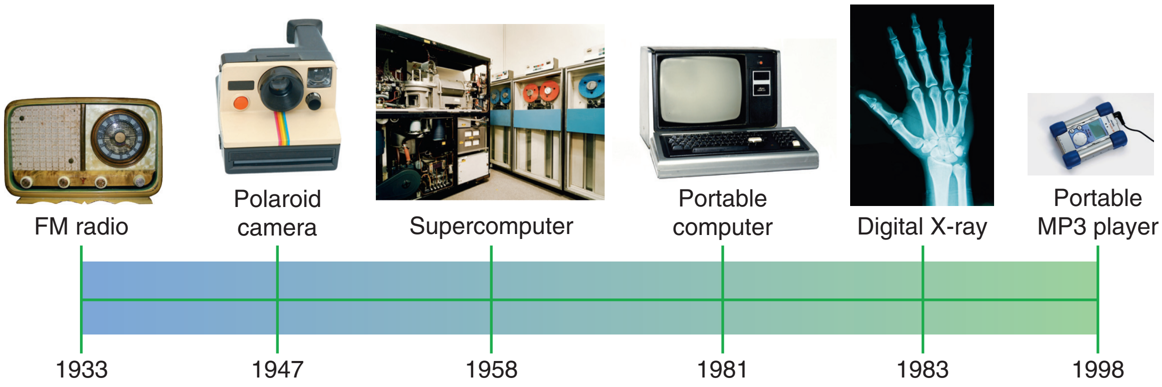


Figure 4.1 Twentieth-Century Entrepreneurial Innovations

the price and thus make automobile ownership affordable to the average worker. Ford's innovative assembly process became the standard for efficient manufacturing. Think about other entrepreneurs and the innovation behind their success. Ben Cohen and Jerry Greenfield of Ben & Jerry's Ice Cream didn't invent ice cream; rather, they capitalized on people's growing desire for high-quality food products and used the best and biggest chunks of nuts, fruits, candy, and cookies in their ice cream.[5] **Figure 4.1** lists some other important innovations by entrepreneurs in the twentieth century.[6]

How do entrepreneurs take risks? Being an entrepreneur involves risk—the risk of failure, the risk of losing one's career, and of course financial risks. Because entrepreneurs are often creating new and innovative products, the processes they develop are often untried and therefore involve risk. Successful entrepreneurs are aware of these risks, recognize that they can influence events but do not have complete control over them, and are willing to accept the knowledge that they may fail. Successful entrepreneurs therefore take calculated risks—that is, they consider the likelihood of success before deciding whether to take a particular risk.

What makes entrepreneurs motivated to succeed? Entrepreneurs are motivated by many different factors. Some entrepreneurs are motivated to provide for themselves or their families. These individuals may be driven to pursue multiple ventures before uncovering a successful idea. Other entrepreneurs are motivated to succeed by the personal fulfillment they feel upon successfully launching a business.

Entrepreneurs' keen desire to succeed has led one entrepreneur, Ted Kennedy, to start a company rooted in this notion. Kennedy noticed that many participants in the Ironman triathlon were corporate executives. He also noticed that these executive triathletes sought above-average accommodations prior to and during their competition. So he formed CEO Challenges, a company that organizes luxury sports experiences for corporate executives. CEO Challenges provides luxury accommodations the night before a race, ensures family members and friends are positioned alongside the race to have the perfect view of their racer, and offers other amenities an executive might want when competing in physical challenges.[7]

Why do successful entrepreneurs need to be flexible and self-directed? Because entrepreneurial ventures are subject to uncertainty and risk, entrepreneurs need to be able to react quickly to new and unexpected situations. And because entrepreneurs are

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SELF CHECK Becoming a successful entrepreneur involves a complex blend of skill, savvy, and luck. Before embarking on such an endeavour, however, you'll need to familiarize yourself with a few concepts. Test your entrepreneurial vocabulary with the following quiz.

1. "It's all about fulfilling an opportunity niche!" Liza, a budding entrepreneur, exclaims. Liza is likely referring to
   A. a need in the market.
   B. a storage nook.
   C. a sense of belonging.
2. A system thinker is someone who
   A. contemplates the technological side of a business.
   B. focuses on the entire process of turning an idea into a reality.
   C. designs methods of doing things.
3. Micropreneurs are likely to
   A. be petite.
   B. hire thousands of employees.
   C. enjoy running a small business.
4. When you hear the word *gazelle*, you think
   A. antelope.
   B. fast-growing business.
   C. graceful.

Are you confident in your understanding of entrepreneurial lingo? Or do you need a primer in the use of these terms? Whatever the case, read on for in-depth information on entrepreneur basics, types of entrepreneurs, and what it takes to be an entrepreneur.

Maridav/Shutterstock

Entrepreneurs are self-directed and innovative, but they rarely work alone. At some point everyone needs someone else with complementary skills to help in the venture.

their own bosses, they need to be able to make their own decisions. An entrepreneur must be able to wear many hats, acting not only as the executive but also as the sales manager, financial director, administrative assistant, and mailroom clerk.

Why are people skills and leadership skills important to entrepreneurs? They may come up with the initial idea behind their business, but entrepreneurs rarely work by themselves. At some point most entrepreneurs need other people with complementary skills to join them in their venture. If their business expands, they must hire employees and other managers to help them run it. Leadership and communication skills are therefore important traits of successful entrepreneurs who must motivate others to feel as passionately about the entrepreneurial enterprise as they do.

What does it mean for entrepreneurs to be "system" thinkers? Although entrepreneurs develop companies from an idea, they must focus on the entire process of turning their idea into a business to succeed. Successful entrepreneurs are able to see the whole picture when they set up their businesses. They determine how to resolve a problem or capitalize on an opportunity by developing a solid plan, including the production, financing, marketing, and distribution of the service or product. For example, while on a canoe trip in northern Ontario, Greg Taylor, Cam Heaps, and Greg Cromwell sat around a campfire dreaming of running their own brewery one day. This dream became a reality when they wrote a business plan and attracted investors with their vision and passion. In 2000 they opened Steam Whistle Brewing in Toronto, brewing a premium pilsner that competes with the best in the world. The three friends saw the opportunity and began the process of creating their company not with just an idea but with a system: Use quality natural ingredients, employ "good beer folks," and "do one thing really really, really well." In 2013 Steam Whistle won a number of awards including the Ontario Craft Brewers Centre of Excellence awards in Product Quality and Process Innovation, and Sustainability Accomplishments.[8]

Types of Entrepreneurs

Are there different types of entrepreneurs? Beyond the traditional entrepreneurs described in the previous sections, other entrepreneurial categories have begun to crop up:

- lifestyle entrepreneurs
- micropreneurs
- home-based entrepreneurs
- Internet entrepreneurs
- growth entrepreneurs
- intrapreneurs

lifestyle entrepreneurs
Entrepreneurs who look for more than profit potential when they begin a business.

What are lifestyle entrepreneurs? **Lifestyle entrepreneurs** look for more than profit potential when they begin a business. Some lifestyle entrepreneurs are looking for freedom from corporate bureaucracy or the opportunity to work at home or in a location other than an office. Others are looking for more flexibility in work hours or travel schedules.

micropreneurs
Entrepreneurs who start their own business but are satisfied with keeping the business small in an effort to achieve a balanced lifestyle.

What are micropreneurs? **Micropreneurs** start their own business but are satisfied with keeping the business small in an effort to achieve a balanced lifestyle. For example, a micropreneur might open a single restaurant and be satisfied with running only that one restaurant, instead of expanding as Ray Kroc did with the McDonald brothers' restaurant. Micropreneurs, or small business people, have no aspirations of growing large or hiring hundreds or thousands of employees. Businesses such as dog-walking services, painters, and special-occasion cake bakers would all be considered micropreneurial opportunities.

What are home-based entrepreneurs? As the name suggests, **home-based entrepreneurs** are entrepreneurs who run their businesses out of their homes. Sheena Edwards was a stay-at-home mom who was looking for a creative outlet. She decided to start making crystal-embellished women's flip-flops and now runs Lizzie Lou Shoes from her home. Production of the shoes is managed by Edwards's cousin in New Delhi, India. "I love owning my own business, as it gives me the creative outlet I crave while still allowing me to be home with my kids and not miss a thing (with the exception of sleep!)," says Edwards.[9]

home-based entrepreneurs Entrepreneurs who run their businesses out of their homes.

In addition to offering lifestyle advantages, such as being able to stay at home with children, home-based businesses offer several financial advantages. Staying at home eliminates commuting time and costs, as well as office rent and other overhead expenses. Also, home-based entrepreneurs can take advantage of tax deductions for part of their rent or mortgage payment, property taxes, insurance, utilities, and home repairs and improvements.

What are Internet entrepreneurs? Advances in technology have spawned another type of entrepreneur, the **Internet entrepreneur**, who creates businesses that operate solely online. The advent of Web 2.0 technologies (e.g., blogging and social networking), smartphone apps, contextual web-based advertising (e.g., Google Ads) that helps to provide revenue, along with faster broadband connections has meant that a greater number of successful online businesses are being established. Some of the most famous Internet entrepreneurs include Mark Zuckerberg (Facebook), Jeff Bezos (Amazon), Pierre Omidyar and John Donahoe (eBay), Sergey Brin and Larry Page (Google), and Jimmy Wales (Wikipedia).

Internet entrepreneurs Entrepreneurs who create businesses that operate solely online.

Youth may have an advantage in this entrepreneurial genre because success requires little investment, some spare time, and a good understanding of what their peers are looking for. For example, David and Catherine Cook and their older brother Geoff started MeetMe (formerly MyYearbook.com) over spring break in 2005. The social networking site invites members to meet new people through playing games, chatting, and sending virtual gifts purchased with Lunch Money, the site's virtual currency. Members are also given the opportunity to donate Lunch Money to their favourite charity through their charity application. MeetMe has over 1 billion page views on mobile devices and 1.2 billion page views on the web each month. In 2013, the social networking company had revenue of approximately $39 million.[10]

growth entrepreneurs Entrepreneurs who strive to create fast-growing businesses and look forward to expansion.

intrapreneurs Employees who work in an entrepreneurial way within the organizational environment.

What are growth entrepreneurs? **Growth entrepreneurs** strive to create fast-growing businesses and look forward to expansion. The companies that these types of entrepreneurs create are known as gazelles. Typically, a gazelle business has at least 20 percent sales growth every year for five years, starting with a base of at least $100 000.[11] It is hard to recognize a gazelle business during its rapidly growing period, though companies such as eBay and Google can clearly be identified in retrospect as having been gazelles in their early years.

Andrew Miller/Newscom

Catherine Cook, at the age of 17, co-created the wildly successful website MeetMe with her older brothers Dave and Geoff during spring break.

What are intrapreneurs? You don't necessarily have to leave your company to have an entrepreneurial experience. Some companies are fostering **intrapreneurs**—employees who work in an entrepreneurial way within the organizational environment. At the home appliance company Whirlpool, for example, developing intrapreneurs is an important part of corporate success. The company's success depends on producing creative solutions to household problems. Instead of relying solely

On Target

Facebook's Mark Zuckerberg

When Mark Zuckerberg, a Harvard student, came up with the idea for Facebook, he didn't realize that he was spearheading a billion-dollar organization. The idea behind "The Facebook," as it was originally called, was to provide a forum for students on the Harvard campus to network and display pictures of themselves and their friends. The site was launched on February 4, 2004, and within a month half of the undergraduates on the Harvard campus were users of the site. Expansion came quickly, as Dustin Moskovitz and Chris Hughes joined Zuckerberg to help promote the site. Within two months, the entire Ivy League was included in the Facebook network. In September 2005, these entrepreneurs decided to allow high schools to join the network. Finally, on September 11, 2006, the public was allowed to join Facebook, so long as all potential members had a valid email address and were at least 13 years old.

On May 18, 2012, Facebook sold shares to the public for the first time, which proved to be highly controversial.[14] The IPO (initial public offering) was one of the biggest in technology history, and certainly the biggest in Internet history, with a peak market capitalization of over $100 billion.[15] A lot of "hype" in the media likely contributed to inflating share prices. Shortly after the stock peaked its value began to drop quickly, and within three months the company's stock had fallen by 50 percent, wiping out $50 billion in shareholder value.[16] Despite the controversy, the site has more than 1.6 billion monthly users worldwide and is constantly expanding, so many analysts still see Facebook as a good investment.[17]

Yaacov Dagan/Alamy

Discussion Questions

1. **Why do you think Facebook is so popular? Is it without problems?**
2. **How was Facebook able to grow so quickly? What marketing strategy was used?**
3. **Research Mark Zuckerberg on the Internet and read about the history of Facebook. What characteristics does Zuckerberg have that relate to those of entrepreneurs?**

on the traditional research and development (R&D) process, Whirlpool management is tapping the creative juices of their employees by encouraging them to generate ideas that will enhance the company's existing products. Although employees are not separately compensated for their ideas, they are pleased that the company asks for their ideas and have responded enthusiastically. By the end of the first year of the program, 60 ideas were in the prototype stage and 190 were close to entering the marketplace.[12,13]

Starting Your Own Business

LO2 Describe the factors that lead to small business failure, and explain why a business plan is crucial to small business success.

Why would I want to start my own business? People start small businesses for many different reasons (see **Figure 4.2**):

1. *Opportunity knocks.* An idea for a new company often starts when someone envisions a product or a service that isn't being offered yet. Other people create opportunities from their own obstacles. For example, a father frustrated at watching his autistic

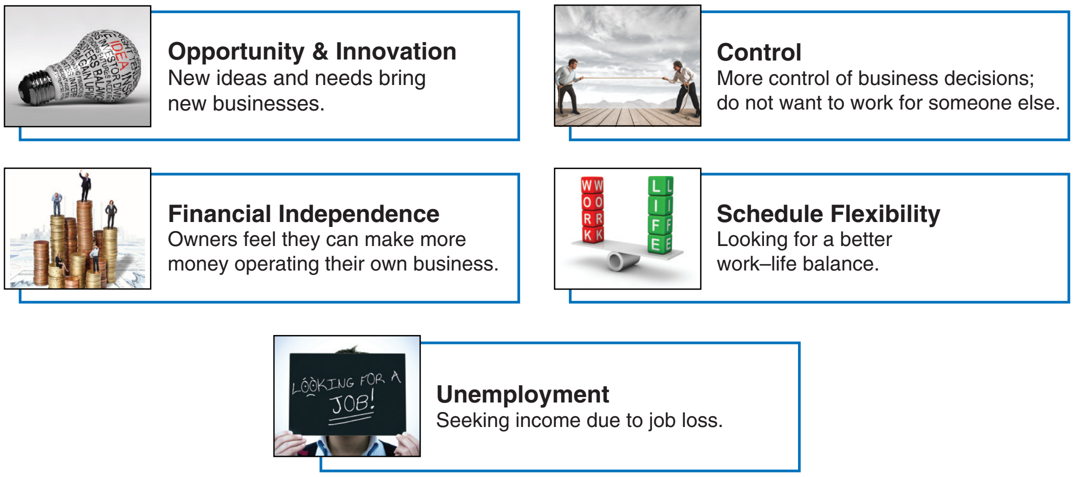

Figure 4.2 Reasons to Start a Small Business

Image Sources: top to bottom, left to right: Carsten Reisinger/Fotolia; alphaspirit/Fotolia; tiero/Fotolia; almagami/Fotolia; alphaspirit/Fotolia

child try to communicate with others founded the Animated Speech Corporation, a company that develops software-based conversational language learning systems to help autistic children communicate.[18]

2. *Financial independence.* Many people begin a small business because they want financial independence, though this should not be the sole reason. Most small businesses don't start out as profitable ventures. Traditionally, it takes three to five years for new businesses to become profitable.
3. *Control.* Many people starting their own business state that they want more control over business decisions than their current position allows. Others know that they aren't satisfied working for someone else.
4. *Flexibility.* Many small business owners appreciate the work–life balance that owning their own business affords. Many also feel working in a small business is more rewarding than working for a larger company. Small business owners believe their companies offer less bureaucracy and more flexibility than larger firms. With fewer channels to go through when decisions need to be made, small business owners can react more quickly to take advantage of immediate opportunities. In addition, small business owners say running their own business gives them the flexibility to adjust their work to their particular situations.
5. *Unemployment.* Whereas most individuals start their own businesses for the reasons mentioned previously, some are pushed into starting their own business because they have no other employment opportunities. "Life begins when you get fired," was exactly the case for Bruce Freeman, owner of ProLine Communications, Inc. Three months after being fired, he couldn't think of what to do next. Then, encouraged by a friend, Bruce started his own business. His first client was a company he worked with in his previous job. Now, over 10 years later, he's making more money than he ever could have in his old job.[19]

What are the advantages and disadvantages of owning a business? Operating a business is a lot of hard work and comes with no guarantee for success. Small business survival rates in Canada decline over time. About 96 percent of small businesses that enter the marketplace survive for one full year, 85 percent survive for three years, and 70 percent survive for five years.[20]

Substantial benefits await the successful entrepreneur, including financial rewards (profit), social rewards (pride, making a difference, worthwhile cause), and independence (work for yourself, at your own pace).

Svanblar/Shutterstock

Sometimes being fired is the best thing that could happen to you! Some entrepreneurs get started when they have no other employment opportunities.

Amy Walters/Shutterstock

Staring your own business is not without risk. Unfortunately, many small businesses fail, and failure can mean substantial financial loss for the owner.

However, with these rewards come potential risks:[21]

- *Financial risk.* Substantial financial loss and even bankruptcy are possible results of business failure. Business owners also have to take taxes and insurance costs into consideration, such as a health insurance plan to cover employees. They also need liability insurance, which will protect the company in the event of stolen or damaged property or if an employee is injured on the job. For example, if a local jewellery store is broken into and inventory is stolen, liability insurance will cover the cost of the broken window and the stolen property. If the jewellery store is not insured, the business could go bankrupt if the owner can't afford to cover the loss and damages.
- *Social risk.* Due to the excessive amount of time an entrepreneur has to devote to a new business venture, he or she has less time for family, friends, and social events, so the potential for losing a friend or even a marriage is very real.
- *Career risk.* Entrepreneurs usually quit their jobs to pursue their own startup, but if things go wrong in the new business venture it may be difficult to resume a career.
- *Psychological risk.* Owning your own business can be rather stressful. There is a difference between good stress (eustress), which gives a person enough adrenalin to handle difficult situations in a positive way, and bad stress (distress), which can hurt the entrepreneur and the business. Some factors that may cause distress are having too much worry, working too hard for long periods, and having no one to turn to for help when feeling overstressed.

While many entrepreneurs feel that the rewards of owning their own business are worth the risks, it's important to be aware of why businesses fail. These reasons include

- accumulating too much debt
- inexperienced management
- poor planning

Let's look at each of these reasons for failure in more detail.

What causes excessive debt accumulation? One reason many new businesses fail is that they accumulate too much debt. Most begin a new business by borrowing funds. Regardless of whether the loan comes from a bank, an outside investor, or a credit card company, if the new business does not generate returns quickly enough to begin to pay back the initial loan, there is temptation to take on more debt to keep the business running. Interest on loans can accumulate quickly, causing an owner to become further entrenched in a potentially unrecoverable situation. What's worse is that some business owners borrow against their personal assets, putting them at risk of personal bankruptcy.

How does inexperienced management lead to failure? Although entrepreneurs and small business owners are good at coming up with ideas, they may not be great at managing the books and their employees. Many inexperienced business owners ignore the signs of a business beginning to fail or attribute the failure to the wrong reasons. In addition, although owners need to build a team they can't hand over all control. Good management stays on top of all aspects of the business and makes the tough decisions when necessary. As Nina Riley, CEO and founder of Water Sensations, a company that

Figure 4.3 A Business Plan Outlines a Company's Goals and Strategies

makes clear-liquid flavour enhancers for water, says, "When things go bad—at the first indication—you gotta nip it in the bud, wrestle it to the ground to fix it. You just can't let it go. If this is your own company, you have to strive to be perfect."[22]

How important is planning to business success? Accumulating debt and poor business management happen after the business has developed. One of the biggest reasons businesses fail is that there was no formal plan in place to begin with. Planning is sometimes harder than doing because it takes time, brainwork, and requires delaying your personal gratification, but the old adage is true: "Businesses that fail to plan, plan to fail." The good news is that poor planning is completely avoidable once you know what kinds of planning you should do before you start your small business.

A **business plan** is a formal document that states the goals of the business as well as the plan for reaching those goals. A business plan should tell the story of your business concept—it is a blueprint for the company, and it is an indispensable tool in attracting investors or obtaining loans. Preparing a business plan takes a lot of time, but it is time well spent because your business plan is an ongoing guide. You use it to acquire startup capital as well as to assess your company's progress, as long as you remember to update it periodically.

business plan A formal document that states the goals of the business as well as the plan for reaching those goals.

A realistic business plan forces you to think critically about your proposed business and reduces your risk of failure. Business plan templates are available online, and the Royal Bank of Canada (RBC) has a very useful site (www.rbcroyalbank.com/sme/) for entrepreneurs starting a business, which includes sample business plans and templates.

Business plans vary in format and number of sections. The main components in most business plans are shown in **Figure 4.3** and include the company's mission statement, history, and the qualifications of the owners and management team and any resources they might have to contribute to the business. It also includes a marketing plan, an operational plan, a financial plan, a risk analysis, and identifies the competition and highlights opportunities for success.

Video: Wild Planet: The Entrepreneurial Spirit

STARTING A SMALL BUSINESS

LO3 Compare the advantages and disadvantages of starting a business from scratch to buying an existing business.

Entrepreneurs usually start a small business by starting from scratch (building a new business), buying an existing business, or buying a franchise.

Starting a Business from Scratch

What are the advantages of starting a business from scratch? Although starting from scratch is the riskiest way to take ownership of a business, most entrepreneurs choose this option because there are a number of attractive benefits:

- *Freedom to do what you want.* When building something new there is opportunity to make all the important decisions such as location, equipment, staff selection, and supplier relationships.
- *You can start small and grow the business over time.* Buying an existing business can be costly, but starting from scratch, particularly if it's a home-based business, may be possible with a modest investment.
- *The satisfaction of building something from nothing.* Many entrepreneurs are inspired by the challenge of creating something new and are passionate about bringing their ideas to life.
- *You can create the image and reputation you want.* There is no negative impact of a previous owner's bad decisions when you start a business from scratch, so you have a blank slate and can build your own reputation.

Video: Toms

What are the disadvantages of starting a business from scratch? Starting a business from scratch is not an easy proposition. There is a lot of hard work involved, and it is very risky. Some of the disadvantages of starting a business from scratch include the following:

- *The business has no proven track record.* A new business has not produced any results, so it is uncertain if the business plan will lead to actual profits. Although the plan should be based on significant market research, the success of the business is always a gamble until proven by real results.
- *It takes time to build a good reputation.* A new business is unknown to customers, so a great deal of effort is needed to develop relationships and build a strong brand. This takes years.
- *Nothing is established—you need to do everything.* Equipment must be purchased, locations determined, facilities set up, staff hired, procedures developed, and supplier relationships established. Although these decisions are critical, they consume many weeks.
- *There is no existing cash flow, and it can take a long time before the business begins to earn a profit.* A new business starts with no customer base and zero sales. It usually takes several years before the business begins to earn a profit, so during this time owners need to have access to large amounts of cash to keep the business operating until it can support itself.
- *It can be difficult to obtain financing.* For all the reasons stated above, starting a business from scratch is extremely risky. Since financial institutions are highly risk averse, it can be difficult to secure loans or even credit from suppliers until the business has proven to be viable.

Buying an Existing Business

What are the advantages of buying an existing business? While starting from scratch is a popular way to begin a business, another way is to buy a pre-existing business. Many experts recommend buying an existing business because this option has certain important advantages:

- *Ease of startup.* It's often simpler to buy an existing business than to start one from scratch. For example, there is a reduction in startup time and energy when you purchase an operational business that has no serious problems. This means that suppliers, existing staff and management, and equipment and inventory are all in place to help facilitate the transition.
- *Existing customer base.* An existing business may have a satisfied customer base already in place. If no significant changes are made to drive away current customers, the business can continue to run and provide immediate cash flow.
- *Financing opportunities.* If the business has had a positive track record, it might be easier to obtain financing to purchase the existing business.

Video: Domino's Pizza: Franchising

Table 4.1 Things to Consider before Buying a Business

Initial Questions to Ask
Why is the business for sale?
What do current customers say?
How much time does the current owner put into the business?
Are there opportunities for growth?
Who is the competition?
Due Diligence Checklist
Get an independent valuation of inventory and equipment.
Have an accountant go over financial statements for the past three years.
Have a lawyer analyze pertinent business documents (property leases, employment contracts, etc.).
Talk to suppliers to see if they will continue to supply the business when ownership changes hands.
Check for lingering or festering hazardous waste problems—they'll become your responsibility as the new owner.

What are the disadvantages of buying an existing business? There are also disadvantages to buying an existing business:

- *High purchase price.* Because you may need to buy the owner out of the business, the initial purchase price may be high. This can be more than the immediate upfront costs associated with a startup, but not necessarily any different from a franchise. Although you can easily determine the value of the physical business and its assets, it is more difficult to determine the true value of the previous owner's goodwill—the intangible assets represented by the business's name, customer service, employee morale, and other factors—that might be lost with a change in ownership. Often the intangible assets are overvalued, making the business cost more than it is worth.
- *Inheriting the previous owner's mistakes.* If the previous owner made some poor choices, you may have to deal with the ramifications. For instance, you might inherit dissatisfied customers, bad debt, and unhappy distributors or purchasing agents. You'll need to work to change the minds of people who have had a bad experience with the previous ownership.
- *The Unknowns.* There is no guarantee that existing employees, management, customers, suppliers, or distributors will continue to work with the business once new ownership takes over. If staff does stay, you might be inheriting unanticipated problems.

What do you need to check before you buy a business? Existing businesses are sold for many reasons. Before buying an existing business, make sure you perform **due diligence**—research and analyze the business to uncover any hidden problems associated with it. You want to avoid buying a company with a dissatisfied customer base or with a large amount of unpaid bills. **Table 4.1** provides a brief checklist of things you should look into before buying a business. However, not all businesses for sale have problems. For example, some family-run businesses run out of family members to pass the business on to, so the owners might be left with no choice but to sell the business. Whether you buy an existing business or franchise or begin a business of your own, you'll be joining a large group of small business owners who make a significant contribution to the Canadian economy.

due diligence Researching and analyzing the business to uncover any hidden problems associated with it.

Buying a Franchise

LO4 Outline the advantages and disadvantages of franchising.

What is a franchise? A **franchise** is a method of doing business whereby the business (the franchisor) grants the purchaser (the franchisee) the right to use its brand name and to sell its goods and services for a specified time. In return, the franchisee provides a

franchise A method of doing business whereby the business (the franchisor) grants the buyer (the franchisee) the right to use its brand name and to sell its goods and services for a specified time.

Table 4.2 Helpful Websites for Potential Franchisees

www.betheboss.ca	BeTheBoss.ca is an information and resource directory for buying a franchise in Canada.
www.cfa.ca	The Canadian Franchise Association educates Canadians about franchising, specific franchise opportunities, and proper due diligence.
www.canadabusiness.ca/eng	The Canada Business Network offers government services for entrepreneurs, information about grants and loans, and links to many other resources.
www.entrepreneur.com/franchises/index.html	Entrepreneur.com's Franchise Zone allows users to search a directory of franchising opportunities and provides tips on buying a franchise. This site also ranks the top franchises in terms of growth, cost, global appeal, and other aspects.
www.franchise.org	The International Franchise Association provides answers to frequently asked questions about franchising and resources for potential and current franchisees. This site also hosts a directory of franchising opportunities in various industries.
www.franchiseinfo.ca	*Canadian Business Franchise Magazine* offers a unique, behind-the-scenes look at those entrepreneurs who have embraced the franchise lifestyle.

share of the income back to the franchisor. Franchising is one of the more popular business venture concepts in Canada. According to the Canadian Franchise Association (CFA), the average term of a franchise agreement in Canada is five years, although franchise agreements come in several fixed periods, including 10 and 20 years.[23] **Table 4.2** lists some helpful websites for potential franchisees.

What are the advantages of franchising? For many, franchising is an easier, less risky means of starting a business. Since the franchisor provides much of the marketing and financial tools needed to run the business, all the franchisee is expected to bring to the table is management and marketing skills, time, and money. In addition to a recognized brand name, there are many other advantages of owning a franchise:

- *It is a proven system of operation.* Instead of wading through the muddy waters of new business ownership by themselves, franchisees benefit from the collective experience of the franchise company. The franchisor has determined, through trial and error, the best system of daily operations for the established business. New franchisees can therefore avoid many of the common startup mistakes made by new business owners since they will be working with standardized products, systems, and financial and accounting systems.
- *There is strength in numbers.* You are not alone when you buy a franchise. Because as a franchisee you belong to a group, you might benefit from economies of scale achieved by purchasing materials, supplies, and services at discounted group rates. In addition, it is often easier to get approval for business loans when running a franchise, as the lending institution associates less risk with a franchise.
- *Initial training is part of the deal.* The beauty of franchising is that you're in business for yourself but not by yourself. The franchisor offers initial training to ensure a successful store opening and might offer ongoing training if new products or services are being incorporated into the franchise line.
- *Marketing support is provided.* As a franchisee, you are often given marketing materials generated at the corporate level and have the benefit of any national advertising programs that are created. Although you are expected to run your own local marketing efforts, you have the support of other franchisees in the area and the recognition of an established brand to help you in your efforts.

- *Market research is often provided.* Good franchisors do considerable market research and can generally conclude whether there is demand for the product or service in the area before selling the franchisee a franchise. The franchisor should also help identify the competition and offer strategies to differentiate the franchise from them.

ZUMA Press, Inc./Alamy

There are many benefits of owning a franchise. Tim Hortons is one of the most recognizable brands in Canada, and some say that owning a Tim Hortons franchise is like having a licence to print money! However, this kind of brand awareness comes with significant costs attached.

What are the disadvantages of franchising?

Although buying a franchise provides the franchisee with many benefits, there are some disadvantages too:

- *Lack of control.* There is not much opportunity to contribute creatively to the franchise since the franchisor often controls the look of the store and the product or service. The franchisee, however, is expected to bring the necessary drive and spirit to make the franchise a success.
- *Startup costs.* More than 70 percent of all franchises require more than $50 000 to start. In addition, franchisees must pay a monthly royalty fee to the franchisor. The royalty fees are due regardless of how the business is doing and can be a huge overhead expense. Other costs the franchisee might incur include real estate purchase or rental, equipment purchase or rental, extra signage, and opening inventory. For example, a Tim Hortons franchise in Canada costs $480 000 to $510 000, with at least $153 000 of this being liquid or cash assets. In addition, a franchisee must have at least $50 000 in startup cash. Royalty fees of 4.5 percent on gross sales are paid each week, advertising fees of 4 percent on gross sales are paid each month, and rental fees of 8.5 percent of gross sales are paid each month.[24]
- *Internal competition.* Some franchises do not restrict the location or number of their franchise locations. In those instances, franchisees could experience serious competition not only from another company but also from other franchisees in the same franchise organization.
- *Share common problems.* If the franchisor or another franchisee is having problems, all franchisees will feel its pain. For example, when a Wendy's restaurant was falsely accused of serving chili with a human thumb mixed in, business in all Wendy's restaurants plummeted.

What are things to watch out for when considering buying a franchise? The most common piece of advice offered to anyone interested in buying a franchise is to do your homework up front. Although a lot of the startup process is done for you, you are still buying a business that will require your time and money and is not guaranteed to succeed. **Table 4.3** shows suggested questions to ask the company that you are buying the franchise from (franchisor) and other people who have bought franchises from the company (franchisees) before you take the plunge.

Video: My Gym: Organizing the Business

Video: Fun Facts about Franchsisng

Small Business Support

Where can small business owners go for help? There are several sources of help that a small business owner can turn to.

Government of Canada, Canada Business Network This government resource (www.canadabusiness.ca/eng) offers startup services for entrepreneurs, including developing a business plan, naming and registering a business, buying a business, and financing a business.

Provincial Small Business Enterprise Centres The Small Business Enterprise Centres (SBECs) across Canada provide entrepreneurs with all the necessary startup and development tools. Each centre can help entrepreneurs determine what they need to do

Table 4.3 Questions to Ask before Buying a Franchise

	Questions to Ask the Franchisor	Questions to Ask Other Franchisees
Competition	• What is the competitive advantage of the product/service? • What makes the business more attractive to an owner and more attractive to a customer?	• How is your system better than competitors'? • How does your business match up? • Who are your competitors?
Franchise System	• How time tested and standardized is the franchise system? • What franchise system is used and how does it work? • How long has the franchise been in business and what improvements has it made recently?	• How long have you been in business? • Does your location meet your customers' needs? • Who selected the site?
Support and Training	• How much support does the franchisor give the franchisee? • What is the initial and ongoing training? • Are there toll-free help lines, field support, annual meetings, local meetings, purchasing programs, and marketing promotion?	• How is your relationship with the franchisor? • How is the initial training, ongoing training, and ongoing support? • How are the marketing, advertising, and promotional programs handled?
Financial Strength	• What is the financial strength of the company and the experience of management? • How much revenue comes from franchise fees and how much revenue comes from royalties? • How has the stock performed?	• Are you pleased with earnings? • Is volume growing?
Franchise Relationships	• How important is the franchisee to the franchise? • How can they describe the relationship with the franchisor? • Have there been any lawsuits/arbitration? • If so, how have they been resolved?	• Do you have second thoughts (would you do this again)? • Would you own more units?

Source: Based on "Checklist of Questions to Answer Before You Buy a Franchise," PowerHomeBiz.com, http://www.powerhomebiz.com/vol2/franchise-checklist.htm.

before, during, and after launching their business. Business support also exists for specific groups, such as Aboriginal entrepreneurs, female entrepreneurs, and young entrepreneurs. (See www.ontario.ca/business-and-economy/small-business-advice-support-services-regulations.)

Industry Canada The business section of Industry Canada's website (www.ic.gc.ca/eic/site/icgc.nsf/eng/h_07064.html) offers business owners many resources (e.g., financing program, internship program) and information on topics such as statistics, research, and regulations.

Small Business Association of Canada (SBA Canada) A nonprofit organization, SBA Canada (www.sba-canada.ca) provides growth and development opportunities to small businesses through networking, mentorship, collaboration, self-development, and education.

Entrepreneurs' Organization (EO) EO (www.eonetwork.org/) provides individual mentoring by connecting business owners with experts in their industry. Although EO is for those who are currently in a viable operation (its requirements are that you must be a founder, cofounder, owner, or controlling shareholder of a business with a minimum of $1 million in annual gross sales and you must be younger than 50 years old), such mentoring services can be helpful to second-stage small business owners.

Business Incubators **Business incubators** are organizations that support startup businesses by offering resources such as administrative services, technical support, business networking, and sources of financing that a group of startup companies share.

business incubators Organizations that support startup businesses by offering resources such as administrative services, technical support, business networking, and sources of financing that a group of startup companies share.

Simulation: Getting Your Business Off the Ground

There are several benefits to incubation beyond sharing a receptionist and copy machine. Business incubators are often run by colleges, universities, and technical schools, and many are sponsored by economic development organizations, cities, or countries. The Canadian Association of Business Incubation (CABI) is a vital national body of organizations dedicated to supporting the growth of new and emerging businesses.

Mario beauregard/Fotolia

Finding the money required to finance your business venture can be challenging. Many business owners use their own personal savings.

FINANCING CONSIDERATIONS

LO5 Summarize the potential benefits and drawbacks of each major source of small business financing.

Personal Financing

Where can I get the money to start a business? Most new ventures need some capital to purchase inventory, secure a physical location, and begin some modest marketing efforts. Most business owners tap into their own personal savings when they initially invest in their business. Friends and family are generally secondary sources of cash. Such contacts are often good sources for financing because, unlike banks or other lending institutions, they often do not require a high rate of return or demand to see the business turn a quick profit. However, it's important when borrowing from friends and family that you treat them as professionally as possible. Make sure you give them a document with an indication of how you intend to pay them back and some sort of a contingency plan if things go wrong. In addition, they should be kept informed of any risks of the venture—both upfront and ongoing.

Can I use credit cards to finance my business? Credit cards offer a convenient way to obtain funds quickly, especially with some of the zero percent financing available. If used wisely, credit cards are a convenient means of acquiring short-term cash, and nearly 50 percent of small business owners use personal credit cards as a source of financing for their small business. However, credit cards should be used only if you can pay the balance completely every month. The risk associated with using credit cards for your initial business financing is the high rate of interest charged on unpaid balances. According to the Financial Consumer Agency of Canada, if you had a $1000 balance on a credit card with an 18 percent interest rate and made the minimum monthly payment, it would take you 10 years to pay off this debt and you would actually pay $1800 in total.[25] The credit card option is expensive if you cannot pay the balance every month.

SELF CHECK Which of the following is a *do* and which is a *don't*?

When financing a business . . .

1. Do or Don't: Give friends and family who you borrow from a document indicating how and when you intend to pay them back.
2. Do or Don't: Rely heavily on credit cards if you can't pay the balance completely every month.
3. Do or Don't: Borrow against your own assets without fully understanding the potentially severe personal consequences of business failure.
4. Do or Don't: Consider applying for a startup loan or line of credit from your bank.
5. Do or Don't: Seek financing from a venture capitalist if the idea of relinquishing any control over your business does not appeal to you.

Answers: 1. Do; 2. Don't; 3. Don't; 4. Do; 5. Don't

Loans and Grants

What if I need more money than I can provide myself? For larger amounts, new business owners sometimes obtain a loan by borrowing against their own assets, such as the equity in their house or against their retirement account, but the consequences of the business failing are very severe. If you're purchasing an existing business or a franchise, banks and other financial institutions often provide funding. In fact, roughly half of all small businesses use bank loans and lines of credit as part of their financing strategy. These institutions offer startup loans and lines of credit to help businesses make payroll during slower periods as well as capital loans to buy equipment or machinery. The Business Development Bank of Canada (BDC) promotes entrepreneurship by providing highly tailored financing, venture capital, and consulting services to entrepreneurs.

grants Financial awards usually offered by federal and provincial governments and some private organizations.

Can I apply for grants to help start a business? **Grants** are financial awards usually offered by federal and provincial governments and some private organizations. The Canadian government realizes that small businesses are a significant part of our economic growth; therefore, the government's Centre for Small Business Financing (www.grants-loans.org/small-business-grants.php) provides the necessary financial resources to facilitate this. The government set aside more than $21 billion in 2011 for small businesses in grants (which are nonrepayable), low- or no-interest loans (repayable), tax refunds or credits, guaranteed loans, financial insurance against business risks, and repayable contributions.[26]

Venture Capital and Other Forms of Financing

What if I need additional sources of funds through investors? There are other sources of funding for your business, such as venture capital, angel investors, or small business investment companies (SBIC):

venture capitalists Investors who contribute money to your business in return for some form of equity—a piece of ownership.

angel investors Wealthy individuals who are willing to put their own money into your business in hopes of a profit return later on.

Small Business Investment Companies (SBIC) Private venture capital firms that make equity capital or long-term loans available to small companies.

- *Venture capitalists.* Unlike banks, where there is a contractual agreement to pay back the money, **venture capitalists** contribute money to your business in return for some form of equity—a piece of ownership. Venture capitalists are very picky about the projects in which they invest. They look for the potential of a public stock offering; therefore, such financing is generally only available to those businesses that have been operating for several years and that have the potential to become larger regional or national companies. To protect their investment, venture capitalists sometimes require that they play an active role in the management of the company, so business owners must be open to the idea of relinquishing some control when they seek venture capital funding.
- *Angel investors.* **Angel investors** are wealthy individuals who are willing to put up their own money in hopes of a profit return later on. Angel capital fills the gap in startup financing between "friends and family" who help provide you with startup money and venture capital. Angel investors are often retired entrepreneurs or executives who may be interested in angel investing for reasons that go beyond purely monetary returns.
- *SBIC program.* If venture capital is not available or suitable, an alternative is the **Small Business Investment Company (SBIC)** program. SBICs are private venture capital firms that make equity capital or long-term loans available to small companies. Canada's Venture Capital and Private Equity Association (CVCA) represents the majority of private equity companies in Canada, with more than 1800 members.

Keep in mind that, to protect their investments, outside investors are often looking for some controlling or managerial role in the business. Funding a business is a task fraught with challenges and difficult decisions. When a great deal of money is on the line, the stakes—personal, professional, and financial—are quite high. Thorough research and careful planning are essential to navigating these tricky issues. By understanding the available options and being prepared to deal with financial predicaments, business owners give themselves the best chance at success.

FORMS OF BUSINESS OWNERSHIP

LO6 Explain the advantages and disadvantages of sole proprietorship.

Sole Proprietorships

sole proprietorship A business owned by one person and not protected by limited liability.

What is it called when one person owns a business? Whether they intend to run large factories, small retail stores, or ebusinesses, entrepreneurs must decide which form of legal ownership best suits their goals: sole proprietorship, partnership, corporation, or cooperative.

A **sole proprietorship** is a business that is owned by one person. A sole proprietorship does not need to register with the government and it is not legally separated from

BizChat

What's in a Name?

Naming a business should be fun, but it can also be stressful, especially if you make some of the more common mistakes:

Mistake 1 | Involving friends, family, employees, or clients in the naming decision. You want to make the name communicate the key elements of your business, not the combined efforts of your friends and family.

Mistake 2 | Description + Product = Name. Although it seems catchy at the time, the result of company names that try to marry description with product is forced and often trite. A service franchise named QualiServe or a day spa named TranquiSpa ultimately aren't the right choices.

Mistake 3 | Using generic names. Gone are the days when General Electric or ACME Foods work as corporate names. In such highly competitive times, when new products or services are fighting for attention, it is best to choose a unique name.

Mistake 4 | Making up a name. While using generic names may not be good, be careful to avoid names that are obscure, hard to pronounce, or hard to spell unless there is solid market research behind it.

Mistake 5 | Using geographic names. Unless you plan to stay local, including a specific geographic name may imply that you won't go beyond that regional territory.

TIP: You might need to hire a company to create a name for you. Acura, Flixx, and Compac are all names that were created by experts.

Discussion Questions

1. **Can you think of a company name that you are not fond of? Do you shop there? Do you wonder why the owner gave it that name?**
2. **Can you think of a company name that is difficult for you to pronounce? Do you think this causes a loss of business for the company?**
3. **Why do you think some business owners name their companies starting with an "A" or an "AA" or sometimes even an "AAA"? Does this make it easy for customers to remember? Can it be confusing for customers?**

the owner. This means the company's debts are the responsibility of the owner, and the owner pays personal income tax on his or her profits rather than corporate taxes. A sole proprietorship is simpler to operate and is under less government regulation than other businesses, but there is also more risk involved. If the company is sued, the owner is liable. If the company owes a debt that the business can't afford to pay, the creditors can legally collect personal assets, such as funds from the owner's retirement accounts, property, or cars. A sole proprietorship is not protected by *limited liability*, which would require owners to be responsible only for losses up to the amount they invested. **Limited liability** safeguards personal assets from being seized as payment for debts or claims.

limited liability Safeguards personal assets from being seized as payment for debts or claims.

How do I start a sole proprietorship? The minute you begin doing business by yourself—that is, collecting income as a result of performing a service or creating a product—you are operating as a sole proprietor. There are no special forms to fill out, nor any special filing requirements with the federal or provincial government. At a minimum, you might need to obtain local licences or permits, or you might have to ensure that you're operating in an area zoned for such business activity.

What are the advantages of being a sole proprietor? There are several advantages to forming your business as a sole proprietorship, the first of which is ease of formation. With only one person making all the decisions and no need to consult other owners or interested parties, sole proprietors have greater control and more flexibility to act quickly. Another advantage is that there are no specific corporate records to keep or reports to file, including tax reporting. Since there is no legal distinction between the owner and the business, no separate tax return is required. As a result, the income and expenses of a sole proprietorship flow through the owner's personal tax return. For example, imagine you run a landscaping business during the summer in addition to your regular job. If the lawn mower breaks down and needs to be replaced, that expense could be more than all the earnings you collected, generating a loss for your lawn mowing business. You can subtract that loss from the income earned from your regular job, reducing your income tax obligation.

What are the disadvantages of being a sole proprietor? If the type of business you're running has the potential for someone to sue you because of errors on your part, you may not want to operate as a sole proprietorship. A sole proprietor is personally responsible for all the debts and liabilities of the business. A **liability** is the obligation to pay a debt such as an account payable or a loan.

liability The obligation to pay a debt such as an account payable or a loan.

A sole proprietor may also incur a liability if he or she becomes responsible for paying for any damages or personal injuries the owner's employees cause. While there may be an unlimited number of employees in a sole proprietorship, there is also unlimited liability for their actions. **Unlimited liability** means that if business assets aren't enough to pay business debts, then personal assets, such as the sole proprietor's house, personal investments, or retirement plans, can be used to pay the balance. In other words, the proprietor can lose an unlimited amount of money.

unlimited liability If business assets aren't enough to pay business debts, then personal assets, such as the sole proprietor's house, personal investments, or retirement plans, can be used to pay the balance.

Imagine that you're running a catering business, and while you're preparing food in someone's house, the oven catches fire because you forgot to take the egg rolls off the paper tray. You are personally responsible, or liable, for paying for any damages if your business assets are not sufficient to cover the damages. If the damages are severe enough—perhaps your client's entire house burns down—you could lose all your assets, including your own home and savings.

Another drawback of a sole proprietorship is the potential difficulty in borrowing money to help your business grow. Banks will be lending to you personally, not to your business, so they will be more reluctant to lend large amounts, and the loan will be limited to the amount of your personal assets.

Partnerships

LO7 Explain the advantages and disadvantages of partnership and describe the importance of partnership agreements.

What are the advantages of bringing in a partner? Sometimes running a business by yourself can be a daunting task, and adding one or more owners can help share the responsibilities. A **partnership** is a type of business entity in which two or more owners (or partners) share the ownership and the profits and losses of the business. There are several reasons why joining with someone else in starting a business makes sense. More owners help contribute to both the starting and ongoing capital of the business. Multiple people are involved in partnerships, so there is more time available to increase sales, market the business, and generate income. Sharing the financial responsibility brings on more people who are interested in the company's overall profitability and are as highly motivated as you are to make the business succeed. Therefore, additional owners, unlike employees, are more likely to be willing to work long hours and go the extra mile.

partnership A type of business entity in which two or more owners (or partners) share the ownership and the profits and losses of the business.

Adding partners to help share the workload also allows for coverage for vacations, illness, or personal issues. Moreover, if partners have complementary skills, they create a collaboration that can be quite advantageous. Partners can help discuss ideas and projects as well as make the big decisions. For example, if you're great at numbers but hate to make sales calls, bringing in a partner who loves to knock on doors would be beneficial for your business.

The two most common partnership forms include general partnerships and limited partnerships. A **general partnership** is similar to the sole proprietorship in that all the (general) partners are jointly liable for the obligations of the business. The **general partners** are full owners of the business, are responsible for all the day-to-day business decisions, and remain liable for all the debts and obligations of the business. Sometimes a business can bring on additional "limited" partners, mostly to provide capital and earn a share in the profits, but not to operate the business. **Limited partners** don't participate actively in the business—they are simply investors and their liability is limited to the

general partnership A type of partnership that is similar to the sole proprietorship in that all the (general) partners are jointly liable for the obligations of the business.

general partners Partners who are full owners of the business and are responsible for all the day-to-day business decisions and remain liable for all the debts and obligations of the business.

limited partners Partners who don't participate actively in the business, and their liability is limited to the amount they invested in the partnership.

amount they invested in the partnership. **Limited partnerships** consist of at least one general partner (who has unlimited liability) and one or more limited partners who cannot participate in the day-to-day activities of the business or they will risk losing their limited liability status.


Stephen Coburn/Shutterstock

Bringing in one or more partners to your business can be beneficial, especially if they have complementary skills to your own. However, choosing a partner is a lot like choosing a spouse: The wrong decision can bring you a lot of challenges and grief.

What are the disadvantages to adding partners?

For every advantage a partner can bring, adding the wrong partner can be equally problematic. Obviously, adding partners means sharing profits and control. A potential partner may have different work habits and styles from you, and if the partner's style isn't complementary the differences can prove challenging. In addition, as the business begins to grow and change, your partner might want to take the business in a different direction than you do. Like entering into a marriage, you want to consider carefully the person(s) with whom you will be sharing your business.

As a form of business ownership, how does a partnership compare to a sole proprietorship? Partnerships and sole proprietorships are very similar; in fact, the biggest difference between the two is the number of people contributing resources and sharing the profits and the liabilities. It's just as easy to form a partnership as a sole proprietorship. The government does not require any special forms or reports—although some local restrictions may apply for licences and permits. For example, if you and your brother-in-law form a small partnership called "All in the Family Electricians," before you are able to do business you might have to apply for a licence, but you do not need any special papers to create the partnership itself. Also, like a sole proprietorship, partnerships do not file a separate tax return. All profits and losses of the partnership flow directly through each partner's own tax return.

limited partnerships A type of partnership that consists of at least one general partner (who has unlimited liability) and one or more limited partners who cannot participate in the day-to-day activities of the business or they will risk losing their limited liability status.

What goes into a partnership agreement? Although no formal documentation is required to create a partnership, it's a good idea to draw up an agreement. A partnership can begin with a handshake, and many of them do, but it is best for all involved parties that a written document, called a *partnership agreement*, formalizes the relationship between business partners. Think of a partnership agreement as a business prenuptial agreement. It helps to settle conflicts when they arise and may discourage small misunderstandings from erupting into larger disagreements. Many points can be included in a partnership agreement; however, the following items should always be included in the agreement:

1. *Capital contributions.* The amount of **capital**, or investments in the form of money, equipment, supplies, computers, and any other tangible thing of value, that each partner contributes to begin the business should be noted in the partnership agreement. In addition, the agreement should also address how additional capital can be added to the business—who will contribute it and whether there will be a limit to a partner's overall capital contribution.
2. *Responsibilities of each partner.* To avoid the possibility of one partner doing more or less work than others, or a conflict arising over one partner assuming a more controlling role than others, it's best to outline the responsibilities of each partner from the beginning. Unless otherwise specified, any partner can bind the partnership to any debt or contract without the consent of the other partners. Therefore, it's especially important to spell out the policy regarding who assumes responsibility for entering into key financial or contractual arrangements.
3. *Decision-making process.* It is important to consider how decisions will be made. Knowing whether decisions will be the result of mutual consent of all or several partners, or whether just one or two partners will make the key decisions is essential to help partners avoid disagreements. What constitutes a "key" decision should also be defined in the agreement. In a partnership of two, where the possibility of a deadlock is likely, some partnerships provide for a trusted associate to act as a third partner whose sole responsibility is to act as the tiebreaker.

capital Investments in the form of money, equipment, supplies, computers, and any other tangible thing of value.

4. *Shares of profits or losses.* Not only should the agreement specify how to divide profits and losses between the partners, but it should also specify how frequently this will be done. One partnership agreement might stipulate that the profits and losses will be proportional to each partner's initial contribution to the partnership, whereas another partnership agreement might just split the profits evenly. It's also important to detail how adjustments to the distributions will be made—if any at all—as the partnership matures and changes.
5. *Departure of partners.* Eventually, the composition of partners will change; original partners will leave and new partners will come aboard. The partnership agreement should have rules for a partner's exit, whether it's voluntary, involuntary, or due to death or divorce. Provisions to remove a partner's ownership interest are necessary so the business does not need to liquidate. The agreement should include how to determine the amount of ownership interest and to whom the departing partner is permitted to transfer his or her interest. It's important to consider whether a partner can transfer his or her ownership solely to the remaining partners or whether individuals outside the existing partnership can buy the departing partner's share.
6. *Addition of partners.* The partnership agreement also helps spell out the requirements for new partners entering the partnership. How the profits will be allocated and whether there will be a "junior partner" period during which the new partner can prove him or herself before obtaining full partner status should also be included.

Corporations

LO8 Explain how a corporation is formed and how it compares with sole proprietorships and partnerships.

corporation A specific form of business organization that is a separate legal entity, that is liable for its own debts, and whose owners' liability is limited to their investment in the company.

What is a corporation?

When you think of corporations, you might think of large companies such as Canadian Tire, BlackBerry, or Air Canada, but any-sized company can incorporate. A **corporation** is a specific form of business organization that is a separate legal entity, that is liable for its own debts, and whose owners' liability is limited to their investment in the company. Because a corporation is considered a separate entity apart from its owners, it has legal rights like an individual, so a corporation can own property, assume liability, pay taxes, enter into contracts, and can sue and be sued—just like any other individual. Unlike partnerships and sole proprietorships, corporations provide business owners with better protection of their personal assets.

How do corporations raise capital?

Sole proprietorships and partnerships, by their nature, are dependent on their founding owners. When an owner dies or otherwise leaves, the partnership or sole proprietorship is usually terminated. On the other hand, shareholders own a corporation, so its existence doesn't depend on its founding members. Shares of ownership are easily exchanged, so the corporation will continue to exist should the owner die or wish to sell his or her interest in the business. In theory, a corporation is capable of continuing forever.

Elena Elisseeva/Shutterstock

People usually think of big companies when they think of corporations, but any-sized business can incorporate, including a one-person consulting firm.

Incorporating offers a business greater flexibility when raising money. Banks and venture capitalists are more likely to lend money to a business that is incorporated. In times when greater sources of funds are needed than venture capital or bank loans can raise, a corporation can extend its ownership by "going public"—selling shares of ownership in the corporation to the public on the stock exchange. A stock certificate is tangible evidence of investment and for some

Figure 4.4 Steps in Forming a Corporation

investors that is very important. Corporations are said to be **public corporations** when shares of stock are widely held and available for sale to the public—such as Bombardier and Petro-Canada. The stock of a **private corporation** is held by only a few people and is not generally available for sale—such as Cirque du Soleil and Pattison.

public corporations Companies whose shares of stock are widely held and available for sale to the public.

private corporations Companies whose shares of stock are held by only a few people and are not generally available for sale.

How is a corporation formed? If a company intends to do business in more than one province, it must incorporate under the federal Canada Business Corporations Act. If a company intends to do business in only one province, it may incorporate under that province's corporation act. Generally, a corporation files **articles of incorporation** with the government, laying out the general nature of the corporation, the name of the corporation and its directors, the type and number of shares to be issued, and the location of the company's operations. Once the articles are approved, the corporation's directors meet to create bylaws that govern the internal functions of the corporation (see **Figure 4.4**). Specific duties of the board of directors and individual board members, committees, and officers are set out in the corporate bylaws. The **bylaws** are the rules of a corporation, established by the board of directors during the process of starting a corporation. All corporations must attach the word "Incorporated" (Inc.), "Limited" (Ltd./Ltée), or "Corporation" (Corp.) to the company name.

articles of incorporation Lay out the general nature of the corporation, the name of the corporation and its directors, the type and number of shares to be issued, and the location of the company's operations.

bylaws The rules of a corporation, established by the board of directors during the process of starting a corporation.

How is a corporation structured? **Shareholders**—investors who buy shares of ownership in the form of stock—are the real owners of a corporation. Dividends are payments made by a corporation to its shareholders. When a corporation earns a profit, it can either reinvest that profit in the business (called retained earnings) or it can be paid to the shareholders as a dividend. Many corporations retain a portion of earnings and pay the remainder in dividends. A dividend is allocated as a fixed amount per share; therefore, a shareholder receives dividends in proportion to their shareholdings (the more shares, the more dividends). Shareholders can attend annual meetings, elect a board of directors, and vote on matters that affect the corporation, in accordance with its charter and bylaws. Each share or stock generally carries only one vote. The shareholders elect a **board of directors** to govern and handle the overall management of the corporation. A corporate board has great power and great responsibility: the board must act with the corporation's best interests in mind. The directors set corporate goals and policies, hire corporate officers (e.g., president, vice-president, CEO, CFO, COO, CIO), and oversee the firm's operations and finances.

shareholders Investors in a corporation who buy shares of ownership in the form of stock.

board of directors A group of people who are elected by shareholders to govern and handle the overall management of the corporation.

What are the advantages of incorporation? Aside from the obvious, biggest advantage of the corporate structure of limited liability, continuity is another advantage. In theory, a corporation could continue forever because shares of stock may be sold or passed on to heirs. As mentioned above, corporations also have an advantage when raising money.

What are the disadvantages of incorporation? It is costly to incorporate and there are many government regulations. Because a corporation is a separate legal entity, many requirements must be fulfilled to maintain the corporate status. For example, all companies must file an annual report and maintain written minutes of annual and other periodic board of director and shareholder meetings. Double taxation is also considered a disadvantage of incorporation. **Double taxation** means that the corporation must pay income taxes on its profits, and the shareholders must pay personal income taxes on the dividends they receive from the corporation.

double taxation Means that the corporation must pay income taxes on its profits, and the shareholders must pay personal income taxes on the dividends they receive from the corporation.

Nonprofit Corporations

LO9 Describe the characteristics of nonprofit corporations and cooperatives.

Must a nonprofit corporation be legally incorporated? Some organizations don't fit the mould of sole proprietorship, partnership, or corporation. When this occurs, business owners might form nonprofit organizations or cooperatives. Legally, a nonprofit corporation is an incorporated business that does not seek a net profit and instead uses revenue available after normal operating expenses for the corporation's declared social or educational goals. Incorporation is not necessary, but to receive limited liability protection a nonprofit organization must file incorporation papers and become established as a separate legal entity.

Similar to a for-profit corporation, a nonprofit corporation is required to hold board of director meetings and to keep complete books and records. The greatest difference from a for-profit corporation is that a nonprofit organization cannot be organized for any person's private gain. Nonprofit organizations do not issue shares of stock, and their members may not receive personal financial benefit from the organization's profits (other than salary as an employee). In addition, should the nonprofit dissolve, the organization's assets must go to a similar nonprofit group.

Do nonprofit corporations generate profits? Nonprofit corporations are not in business to generate a profit. Nonprofit organizations generate their revenue primarily through fundraising and donations. To maintain their tax-exempt status, nonprofit organizations must demonstrate that a substantial portion of their income or revenue is spent on services to achieve their goals. Nonprofit corporations must apply for charitable status to benefit from tax-exempt status and to issue tax-deductible receipts to donors. The Canada Revenue Agency (CRA) is the government department responsible for granting organizations charitable tax status.

What are the benefits of being tax-exempt? As a corporation that has received tax-exempt status, the donations that are the organization's primary source of revenue are tax deductible to the donor, which encourages funding. Other benefits of tax-exempt status are that the nonprofit is exempt from paying most federal and provincial corporate income taxes and may be exempt from provincial sales and property taxes. Such organizations are able to apply for grants and other public or private distributions, as well as discounts on postal rates and other services.

Cooperatives

How do cooperatives differ from the other forms of business ownership?

Cooperatives differ from other forms of business because they have a different purpose, control structure, and allocation of profit. A **cooperative** is a business owned and governed by members who use its products or services, not by outside investors. The primary purpose of cooperatives is to meet the common needs of their members. For instance, Mountain Equipment Co-op is Canada's largest retailer cooperative, which sells outdoor gear, clothing, and offers services to its members. Cooperatives exist in virtually every sector of the economy, from agriculture, retail, and financial services to housing, childcare, funeral services, and renewable energy. See **Table 4.4** for a comparison of the forms of business ownership.

cooperative A business owned and governed by members who use its products or services, not by outside investors.

Video: Elm City Market: Organizational Structure

How are cooperatives structured? Cooperatives depend on their members to volunteer for projects supported by the co-op and serve on boards and committees. The control structure in a cooperative differs from that of a corporation in that each member receives one vote, not one vote per share. This helps cooperatives serve the common need rather than the individual need. Profits are shared among the members based on how much they use the co-op, not on how many shares they hold. Some people may consider the democratic voting arrangement and dividends based purely on patronage a disadvantage and may be discouraged from forming or joining a cooperative.

Table 4.4 Comparison of Forms of Business Ownership

Characteristic	Sole Proprietorship	Partnership	Corporation	Cooperative
Ease of formation	High	High	Medium	Medium
Continuity	Low	Low	High	High
Protection against liability	Low	Low	High	High
Tax advantages	High	High	Low	High
Ease of raising money	Low	Medium	High	High
Government regulation	Low	Low	High	Medium

Business Combinations: Mergers and Acquisitions

LO10 Summarize the different types of mergers and acquisitions and explain why they occur.

What are mergers and acquisitions? Sometimes, in the evolution of a business or in response to market forces, companies seek opportunities to expand by adding new product lines, spreading out into different geographic areas, or growing the company to increase its competitive advantage. Often product or market expansion is done gradually by slowly adding new product lines or penetrating new areas. However, it takes time and investment to research and develop new products or to locate and build in new areas. Often, especially to remain competitive, expansion needs to happen more quickly. In that case, it's easier to integrate another established business through the process of mergers or acquisitions.

A **merger** occurs when two or more firms combine to form one new company, which often takes on a new corporate identity. Generally, a merger implies that the two companies involved are about the same size and have mutually agreed to form a new combined company. When a "merger of equals" happens, both merging companies cease to exist and one new company takes over. For example, in 2009 Suncor Energy merged with Petro-Canada, stating that by merging the two oil companies would create Canada's largest energy company, which would provide protection against potential foreign buyouts.[27]

merger Occurs when two or more firms combine to form one new company, which often takes on a new corporate identity.

Under the Competition Act, mergers of all sizes and in all sectors of Canada's economy are subject to review by the Competition Bureau to determine whether they will likely result in a substantial lessening or prevention of competition. For instance, when TD Bank wanted to acquire Canada Trust in 2000, the Competition Bureau concluded that the merger would likely lessen competition and affect consumers negatively. To remedy the bureau's concerns, TD Bank proposed to sell the branches in the identified problematic markets and either convert its Visa credit card portfolio to MasterCard or sell the Canada Trust MasterCard portfolio. The bureau announced that the government had approved the Canada Trust acquisition contingent upon the proposed remedies being fully implemented.[28]

An **acquisition**, on the other hand, occurs when one company or investor group buys a corporation and the identity of the acquired company might be lost. Often the purchased company ceases to exist, and it operates and trades under the buying company's name. A company can also acquire divisions or subsidiaries of another firm.

acquisition Occurs when one company or investor group buys a corporation and the identity of the acquired company might be lost.

When the acquisition is supported by the target company's management and board of directors, it is called a **friendly takeover**, but if the takeover goes against the wishes of the target company's management and board of directors, it is called a **hostile takeover**. Hostile takeovers are usually accomplished through a *proxy fight*, whereby the acquiring company quietly purchases enough stock on the open market to gain a controlling interest in the company and affect a change in management. Another method used in hostile acquisition occurs through a *tender offer*, where the acquiring firm offers to buy the target company's stock at a price higher than its current value, which is meant to induce shareholders into selling.

friendly takeover Occurs when the target company's management and board of directors support an acquisition.

hostile takeover Occurs when a takeover goes against the wishes of the target company's management and board of directors.

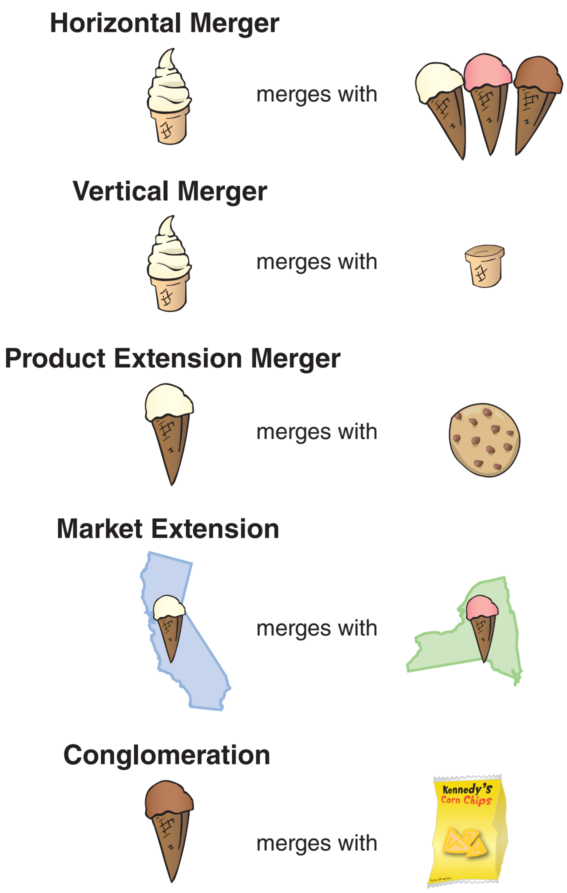

Figure 4.5 Different Types of Mergers

Companies merge for different strategic reasons. Sometimes companies merge to enter new markets, whereas others want to expand into new fields and save costs.

Why do mergers and acquisitions occur?

Synergy is the business buzzword often used to justify a merger or an acquisition. **Synergy** is the achieved effect when two companies combine and the result is better than each company could achieve individually. Synergistic value is created when the new company can realize operating or financial economies of scale (the cost advantage that a business obtains from expansion). Combined firms often lower costs by trimming redundancies in staff, sharing resources, and obtaining discounts accessible only to a larger firm. Often, companies join together to gain a greater competitive advantage or become the dominant force in their market.

Are there different types of mergers?

The rationale and strategy behind every merger is different but, as illustrated in **Figure 4.5**, there are some consistencies that are distinguished by the relationship between the two companies that are merging:

- *Horizontal merger.* Two companies that share the same product lines and markets and are in direct competition with each other, such as a soft drink company and a mineral water company, are merging horizontally.
- *Vertical merger.* Two companies that have a company/customer relationship or a company/supplier relationship, such as Walt Disney and Pixar or eBay and PayPal, are merging vertically.
- *Product extension merger.* Two companies selling different but related products in the same market, such as the 2005 merger between Adobe and Macromedia, are forming a product extension merger.
- *Market extension merger.* Two companies that sell the same products in different markets, such as Morrison and Safeway supermarkets, are forming a market extension merger. Although both Morrison and Safeway are in the United Kingdom, Morrison is mainly in Great Britain and Safeway is mainly in Scotland.
- *Conglomeration.* Two companies that have no common business areas merge to obtain diversification, such as Citicorp, a banking services firm, and Travelers Group Inc., an insurance underwriting company, which combined to form one of the world's largest financial services group, Citigroup Inc.

synergy The achieved effect when two companies combine and the result is better than each company could achieve individually.

Are there disadvantages with mergers?

Although cost cutting may be the initial focus of some mergers, revenues and profits ultimately suffer because day-to-day activities are neglected. Additionally, corporate cultures may clash, and communications may break down if the new division of responsibilities is vague. Conflicts may also arise from divided loyalties, hidden agendas, or power struggles within the newly combined management team. Employees may be nervous because most mergers result in the elimination of jobs and some may actually leave the company, feeling their jobs are in jeopardy and seeking a more stable environment.

CHAPTER SYNOPSIS

LO1 List the traits of an effective entrepreneur, and describe how these characteristics often lead to business success. *(pp. 66–70)*

Successful **entrepreneurs**

- are innovative
- take risks
- are motivated to succeed
- are flexible and self-directed
- work well with others and possess good leadership skills
- are "system thinkers," seeing the whole process rather than just individual pieces of it

Successful entrepreneurs see problems to be solved or opportunities that aren't being addressed in the marketplace—

they recognize **opportunity niches**. They also make improvements to existing products or systems, or they introduce something new and make profitable solutions out of problems.

LO2 Describe the factors that lead to small business failure, and explain why a business plan is crucial to small business success. *(pp. 70–73)*

A **business plan** is a formal document that states the goals of the business as well as the plan for reaching those goals. A business plan should tell the story of your business concept—it is a blueprint for the company, and it is an indispensable tool in attracting investors or obtaining loans. Preparing a business plan takes a lot of time, but it is time well spent because your business plan is an ongoing guide. You use it to acquire startup capital as well as to assess your company's progress, as long as you remember to update it periodically. A realistic business plan forces you to think critically about your proposed business and reduces your risk of failure.

Businesses fail because of the following reasons:

- accumulating too much debt
- inexperienced management
- poor planning

LO3 Compare the advantages and disadvantages of starting a business from scratch to buying an existing business. *(pp. 73–75)*

	Starting from Scratch	Purchasing an Existing Business
Advantages	• Freedom to do what you want • Can start small and grow • Satisfaction of building something new • Can create the kind of image and reputation you want	• Ease of startup • Existing customer base and revenue • May be easier to secure loans because the business has a proven track record
Disadvantages	• It's risky! • The business has no proven track record • It takes time to build a good reputation • Nothing is established; you need to do everything • There is no existing cash flow • It can be difficult to obtain financing	• High purchase price • May inherit previous owners mistakes • There are unknowns

LO4 Outline the advantages and disadvantages of franchising. *(pp. 75–79)*

For many, buying a **franchise** is an easier, less risky means of starting a business. Since the franchisor provides much of the marketing and financial tools needed to run the business, all the franchisee is expected to bring to the table is management and marketing skills, time, and money. In addition to a recognized brand name, other advantages include a proven system of operation, strength in numbers, initial training, marketing support, and market research is often provided as well.

Although buying a franchise provides the franchisee with many benefits, other disadvantages include lack of control, heavy workload, competition, shared common problems, high startup costs, and franchisees must pay a monthly royalty fee to the franchisor. Other costs the franchisee might incur include real estate purchase or rental, equipment purchase or rental, extra signage, and opening inventory.

LO5 Summarize the potential benefits and drawbacks of each major source of small business financing. *(pp. 79–80)*

For larger amounts, new business owners sometimes obtain a loan by borrowing against their own assets, such as the equity in their house or against their retirement account, but the consequences of the business failing are very severe. **Grants** are financial awards that are usually offered by federal and provincial governments and some private organizations. **Venture capitalists** are another source of funding. Unlike banks, where there is a contractual agreement to pay back the money, venture capitalists contribute money to your business in return for some form of equity—a piece of ownership. **Angel investors** are wealthy individuals willing to put up their own money in hopes of a profit return later on.

Often, outside investors are looking for some controlling or managerial role in the business. When a great deal of money is on the line, the stakes—personal, professional, and financial—are quite high. By understanding the available options and being prepared to deal with financial predicaments, business owners give themselves the best chance at success.

LO6 Explain the advantages and disadvantages of sole proprietorship. *(pp. 80–82)*

There are several advantages to forming your business as a **sole proprietorship**, the first of which is ease of formation. With only one person making all the decisions and no need to consult other owners or interested parties, sole proprietors have greater control and more flexibility to act quickly. Another advantage is that there are no specific corporate records to keep or reports to file, including tax reporting. Since there is no legal distinction between the owner and the business, no separate tax return is required. As a result, the income and expenses of a sole proprietorship flow through the owner's personal tax return.

A sole proprietor is personally responsible for all the debts and liabilities of the business. **Unlimited liability** means that if business assets aren't enough to pay business debts, then personal assets, such as the sole proprietor's house, personal investments, or retirement plans, can be used to pay the balance. Another drawback of a sole proprietorship is the potential difficulty in borrowing money to help your business grow.

LO7 Explain the advantages and disadvantages of partnership and describe the importance of partnership agreements. *(pp. 82–84)*

Since a **partnership** has more owners, there are more available contributions to both the starting and ongoing capital of the business. Sharing the financial responsibility means all the owners are interested in the company's overall profitability and are as highly motivated as you are to make the business succeed. Therefore, additional owners, unlike employees, are more likely to be willing to work long hours and go the extra mile.

Adding partners to help share the workload also allows for coverage for vacations, illness, or personal issues. Moreover, if partners have complementary skills, they create a collaboration that can be quite advantageous. Partners can help discuss ideas and projects as well as make the big decisions. Partners can help in sales and marketing to generate income.

For every advantage a partner can bring, adding the wrong partner can be equally problematic. Obviously, adding partners means sharing profits and control. A potential partner may have different work habits and styles from you, and if the partner's style isn't complementary, the differences can prove challenging. In addition, as the business begins to grow and change, your partner might want to take the business in a different direction than you do, so preparing a partnership agreement can help to clarify the partners' expectations of how to run their business and how they plan to resolve any possible disagreements.

LO8 Explain how a corporation is formed and how it compares with sole proprietorships and partnerships. *(pp. 84–85)*

A **corporation** is a separate legal entity, liable for its own debts, and whose owners' liability is limited to their investment in the company. Because a corporation is considered a separate entity apart from its owners, it has legal rights like an individual, so a corporation can own property, assume liability, pay taxes, enter into contracts, and can sue and be sued—just like any other individual. Unlike partnerships and sole proprietorships, corporations provide business owners with better protection of their personal assets.

If a company intends to do business in more than one province, it must incorporate under the federal Canada Business Corporations Act. If a company intends to do business in only one province, it may incorporate under that province's corporation act.

LO9 Describe the characteristics of nonprofit corporations and cooperatives. *(pp. 86–87)*

Legally, a nonprofit corporation is an incorporated business that does not seek a net profit and instead uses revenue available after normal operating expenses for the corporation's declared social or educational goals.

Cooperatives differ from other forms of business because they have a different purpose, control structure, and allocation of profit. A cooperative is a business owned and governed by members who use its products or services, not by outside investors. The primary purpose of cooperatives is to meet the common needs of their members.

LO10 Summarize the different types of mergers and acquisitions and explain why they occur. *(pp. 87–88)*

Sometimes, in the evolution of a business or in response to market forces, companies seek opportunities to expand by adding new product lines, spreading out into different geographic areas, or growing the company to increase their competitive advantage. Often, especially to remain competitive, this expansion needs to happen quickly. In that case, it's easier to integrate another established business through the process of **mergers** or **acquisitions** than try to add new product lines or expand into new areas.

- *Horizontal merger:* two companies that share the same product lines and markets and are in direct competition with each other, such as a soft drink company and a mineral water company.
- *Vertical merger:* two companies that have a company/customer relationship or a company/supplier relationship, such as Walt Disney and Pixar or eBay and PayPal.
- *Product extension merger:* two companies selling different but related products in the same market, such as the 2005 merger between Adobe and Macromedia.
- *Market extension merger:* two companies that sell the same products in different markets, for example, Morrison supermarket and Safeway. Although both are in the United Kingdom, Morrison is mainly in Great Britain and Safeway is mainly in Scotland.
- *Conglomeration:* two companies that have no common business areas merge to obtain diversification, such as Citicorp, a banking services firm, and Travelers Group Inc., an insurance underwriting company, combining to form one of the world's largest financial services group, Citigroup Inc.

MyBizLab Study, practise, and explore real business situations with these helpful resources:

- **Interactive Lesson Presentations:** Work through interactive presentations and assessments to test your knowledge of business concepts.
- **Study Plan:** Check your understanding of chapter concepts with self-study quizzes.
- **Dynamic Study Modules:** Work through adaptive study modules on your computer, tablet, or mobile device.
- **Simulations:** Practise decision-making in simulated business environments.

KEY TERMS

acquisition *(p. 87)*
angel investors *(p. 80)*
articles of incorporation *(p. 85)*
board of directors *(p. 85)*
business incubators *(p. 78)*
business plan *(p. 73)*
bylaws *(p. 85)*
capital *(p. 83)*
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general partnership *(p. 82)*
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Small Business Investment Company (SBIC) *(p. 80)*
sole proprietorship *(p. 80)*
synergy *(p. 88)*
unlimited liability *(p. 82)*
venture capitalists *(p. 80)*

CRITICAL THINKING QUESTIONS

1. Bill Gates, Donald Trump, and Oprah Winfrey are some well-known successful entrepreneurs. What common traits do these individuals possess that have led to their success?
2. Compare the different sources of funding available to small business owners. Which sources of funding seem best when a business is just starting? Which sources of funding seem best once the business is established and is looking to expand?
3. Imagine that you are planning to open a new business in partnership with a close friend. Briefly describe the skills and abilities that your new partner can offer that you lack. What

are the pros and cons of partnering with this person? What kinds of issues do you anticipate might potentially cause disagreement with this person? Write examples of terms you could include in a partnership agreement that would help the business run more smoothly.

4. Discuss the different risks facing someone creating a new business from scratch and someone buying an existing small business. What risks will both new business owners face? Compare the advantages and disadvantages of each option. Which would you rather do and why?
5. Businesses, especially small businesses, often compete for customers through customer experience—customer service, quality of the experience, or exceeding the customer expectations. Imagine that you open your own business. Identify how you could build a competitive advantage by offering a better customer experience. Be specific. What would your business offer customers that would entice them to buy from you instead of your competitors?

APPLICATION EXERCISES

1. **A closer look at franchising.** Using the Internet, research a franchise that you think would be a viable investment opportunity for you. Put together a brief report that outlines the following information about your chosen franchise: fees (initial and ongoing), location/site assistance, training and ongoing support, marketing assistance, competition (both from other businesses and additional franchises within the organization), and the pros and cons of starting a business with this franchise.
2. **Microfinancing: A little $ can go a long way.** Visit www.kiva.org and click on the "Lend" tab to view the list of entrepreneurs. Use the drop-down menus in the "Find Loans" search bar to locate an entrepreneur or entrepreneurial team you would consider lending money to. In a brief report, discuss the entrepreneur or group you chose, including information on the loan amount requested, the percentage of funds raised, the entrepreneur's country of origin, and a summary of the entrepreneur's business venture. In your report, explain your reasons for choosing to loan to this particular entrepreneur.
3. **Do you have what it takes to be an entrepreneur?** Visit the Business Development Bank of Canada's (BDC) website at www.bdc.ca. Go to the Advice Centre, Tools, and complete the Entrepreneurial self-assessment. What aspects of your personality make you a good candidate to be an entrepreneur? What is holding you back?
4. **Business combinations.** Look on the Internet for a current example of a business merger, takeover, or acquisition. Explain the circumstances of the event. What companies are involved? Was the event friendly or hostile? What are the reasons given for the combination? What is your opinion of this business combination? Do you think it is a good business decision? Why or why not?
5. **Small business owners.** In the results of the 2011 Census, Milton, Ontario, was named the fastest-growing community in Canada. Imagine that you want to start a catering business in Milton (or another fast-growing community). You see that a catering business is for sale in Milton for $150 000. The company specializes in catering business events. The owner, currently operating the business from home, is moving to another country and wants to sell. You will need outside investors to help you purchase the business. Develop questions to ask the owner about the business. What other types of information would you need before making a decision to buy this company? Either you will purchase this existing business or start a catering business of your own, therefore you should investigate the feasibility of each option. Once you've gathered the necessary information, visit Sample Business Plans (www.bplans.com) and search for a sample catering business plan and review it. Use the example you found as a starting point to draft an executive summary that will attract investors for your business.

ETHICS AND RESPONSIBILITY

Social Responsibility: Forming a Plan of Action
Milton Hershey, founder of Hershey Chocolate Company, dedicated himself to caring about his customers, his employees, and his community at large. Hershey felt that giving back to the community was not only his moral obligation but also a crucial part of his success.

Step 1. Imagine that you operate a business in your community (choose from a restaurant, a landscaping service, or a beauty salon).

Step 2. As a class or in smaller groups, discuss the ways in which your business can contribute to customers, employees, and the community in socially responsible ways. Write down a list of ideas that your group came up with.

Step 3. Create a social responsibility plan for your company. In the document, describe your business and the ways in which your business can contribute to specific organizations in your community. Be as specific with your plan as possible. Your instructor may ask you to submit your work or discuss it with the class.

CLOSING CASE

The Fish That Pulled Him Under

Born in Europe, avid angler Kevin Hengeveld immigrated to Canada in the early 1980s. In the 1990s, Hengeveld started an import/export wholesale business in Ontario whereby he would import products not currently sold in the Canadian market and sell them to fishing stores all over Ontario. There was a big demand for this type of equipment, especially from Canadians of European descent. He dealt with many fishing storeowners and learned much about how the retail fishing industry worked.

Hengeveld created an online store called Fish in the Net where he could sell his imported goods directly to customers, acquiring many loyal customers. He was very knowledgeable about many types of fishing (i.e., float fishing, carp fishing, sport fishing, ice fishing) and published a fishing magazine in two languages.

During the second year of business, Hengeveld noticed that many stores were not paying on time, but the products were selling well. For many years, Hengeveld had thought about opening his own fishing equipment store. Recreational fishing/angling was a passion of his since he was a small child, so when a retail space became available in 2003 in a wealthy area of town, Hengeveld decided to rent it and start his own brick-and-mortar retail business. The store specialized in European-style fishing and float fishing and sold equipment and bait. Hengeveld continued his wholesale operations, but focused on his new venture. He held seminars at the store and provided information to customers regarding new and current fishing techniques. The business was established as a sole proprietorship, and Hengeveld initially financed the startup of the business through personal savings of $20 000 and a $25 000 line of credit. Later he obtained another $75 000 line of credit. He never did have enough time to write his business plan fully.

The live bait the store sold generated a big percentage of the income, but it also generated a big percentage of the expenses. Not only were storage tanks, refrigerated tanks, and fridges needed, but the government had many regulations pertaining to the type of bait a store could sell and the reporting that must be done. Due to the hours anglers would go fishing, the store had to be open very early in the mornings and 24 hours on the weekends. Staff had to be trained on how to handle live bait. There was a 40 percent loss in bait product, and suppliers insisted on cash payments on delivery with no returns.

The store also sold fishing licences, which required monthly reporting to the Ministry of Natural Resources (MNR) but also attracted customers. A yearly live bait sales report was also required by the MNR, which was very time consuming to create because it detailed the number of fish sold. The business was audited once by the Canada Revenue Agency and it went well because Hengeveld had hired an accountant to be sure all payroll deductions, special reporting, and income tax calculations were accurate and complete.

There was not a lot of competition in the area, just a few small, family-operated stores. Hengeveld's wife helped with the bookkeeping and the purchases and reporting processes when she could, but she also had a full-time career. Hengeveld soon was doing enough business that he actually purchased a second store, taking over his main competitor of the family-operated stores. Hengeveld was doing so well in this second store location that he decided to close the first store, as he was feeling a bit stretched running between the two stores and trying to be a good husband and father. He felt the original store's business was only about half that of the second store so it was best to focus his efforts on the second store, even though the second store was not in as good a neighbourhood and the operating costs were somewhat higher. The property owner had Hengeveld sign a lease that included a clause stating that the lessee was responsible for all repairs and for paying the hydro bills for both the store space as well as the apartment upstairs. To Hengeveld's dismay, the store space was dilapidated, and he found out later that he was responsible for many more repairs than he initially thought.

Hengeveld hired a programmer to update the business website since this was his primary marketing tool, and soon it became the first of its kind for sports anglers in Canada. Customers could order online, use message boards, chat with each other, and arrange to meet at the store and go fishing together. The site offered an interactive experience for customers and brought many new customers not only from Canada but also from the United States.

He installed a security system in his store, and had an alarm system in place because the store was open 24 hours on weekends. Hengeveld had a difficult time finding qualified staff that he could rely on to show up for work and not steal from the store. He had a couple of employees who did not deal with customers well and customers had complained about them to Hengeveld. Part-time staff consisted of mostly college students taking a break from their studies; while most had good customer service skills, they proved unreliable in other ways.

In 2005, a major outdoors store, Bass Pro, opened within a 20-kilometre range, and Hengeveld estimated that he lost around 25 percent of his revenue after the mega store moved in. Business started to slow in 2007 just before the recession hit in 2008. In the beginning, Hengeveld's business was not making a profit, but he was able to cover expenses and repay creditors. During the last few years, the store was losing money. In the end, Hengeveld decided to close his brick-and-mortar store but continue to operate his online store as more of a part-time pursuit.

DISCUSSION QUESTIONS

1. What entrepreneurial traits does Hengeveld have? What made him want to start his own business?
2. Analyze the situation. What do you think went wrong? Did Hengeveld make mistakes? If so, what were they?
3. What might Hengeveld had done differently to continue his business success? Search for one or more sample business plans for a retail fishing store (you should find at least one at www.bplans.com). Review it. What stands out in your mind about the plan? Do you think Hengeveld could have done better with his business if he had a business plan to start with? Why or why not?