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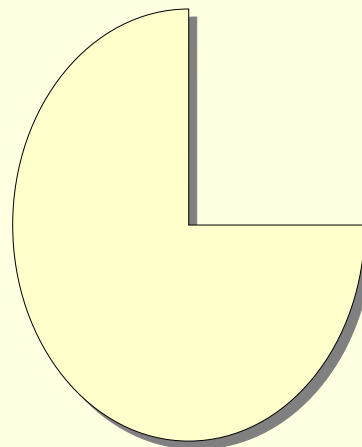
Entrepreneurship and Options for Organizing a Business

Management 3e - Chapter 5

2

Small Business

- An owner-managed business with fewer than 100 employees
- 2.3 million in Canada
- 97.7% of all employer businesses in Canada are "small"
- Account for over 2/3 employment in four industries:
 - Non-institutional health care
 - Construction
 - Accommodation and food
 - Other services



2

The Entrepreneur and the Entrepreneurial Process

- Entrepreneur(s) – people who recognize and seize opportunity
- Entrepreneurship – the process of identifying an opportunity in the marketplace and accessing the resources necessary to capitalize on that opportunity



3

The Entrepreneurial Process

- Identify Opportunities
 - Idea generation
 - Screening:
 - Idea creates or adds value
 - Idea provides a sustainable competitive advantage
 - Idea is marketable and financially viable
 - Idea has low exit costs
 - Develop the opportunity
- Access the necessary resources



4

The Entrepreneurial Process: Applied

- **IDEA: A DOMESTIC CLEANING BUSINESS**

- WHY?

- AGING POPULATION
- MAINTAINING SENIORS IN THEIR OWN HOMES IS CHEAPER FOR THE STATE

5

The Entrepreneurial Process: Applied

- **SCREENING:**

- CREATE VALUE? HOW?

- PROVIDING A SERVICE FOR WHICH THERE IS **DEMAND** (OR A FUTURE DEMAND OR THE EXPECTATION OF AN INCREASING DEMAND)

6

The Entrepreneurial Process: Applied

- **SCREENING: SUSTAINABLE COMPETITIVE ADVANTAGE**
 - WHAT CAN YOU OFFER THAT THE COMPETITION CANNOT?
 - HIGHER QUALITY
 - BETTER SERVICE
 - GREATER CONVENIENCE
 - LOWER PRICE
 - HOW CAN YOU SUSTAIN THIS?

7

The Entrepreneurial Process: Applied

- **SCREENING: THE IDEA IS MARKETABLE AND FINANCIALLY VIABLE**
 - MARKETABLE: WILL PEOPLE BUY IT?
 - FINANCIALLY VIABLE: WILL IT BE PROFITABLE?

8

The Entrepreneurial Process: Applied

■ **SCREENING: LOW EXIT COSTS**

- IF THE IDEA FAILS CAN YOU GET OUT OF BUSINESS EASILY WITH MINIMUM LOSS?
 - WHAT CAN INCREASE EXIT COSTS?
 - CONTRACTUAL OBLIGATIONS WITH HIGH CANCELLATION PENALTY CLAUSES
 - HEAVY INVESTMENT IN EQUIPMENT
 - A COMPLICATED BUSINESS STRUCTURE WITH SEVERAL EMPLOYEES
 - A UNIONIZED ENVIRONMENT

9

The Entrepreneurial Process: Applied

- **RESOURCES: CAN YOU GET THE MONEY TO START THIS BUSINESS?**
 - CASH ON HAND?
 - CREDIT?
 - EQUITY OFFERING?
 - PARTNER(S)?

10

The Canadian Private Sector Forms of Business Ownership

(Source of Information: Robert Sexty: Canadian Business in the New Stakeholder Economy, Prentice Hall Canada, 1998)

- Sole Proprietorship
- Partnership
 - General
 - Limited
 - Joint Venture
- Incorporation
 - Under Federal Laws
 - Under Provincial Laws
 - Public Corporation
 - Private Corporation – (including most “Family Businesses”)
- Alternative Business Forms
 - Crown Corporations
 - Cooperatives
 - Non-Profit

11

The Canadian Private Sector Forms of Business Ownership

(Source of Information: Robert Sexty: Canadian Business in the New Stakeholder Economy, Prentice Hall Canada, 1998)

- Sole Proprietorship (SPs)
 - The simplest form of business organization available to any individual who is legally able to enter into a binding contract
 - SPs fall under provincial and municipal jurisdiction
 - Filing a name declaration is not required provided the proprietorship operates under a person's name
 - Owned and operated by one person

12

Advantages and Disadvantages of the Sole Proprietorship

- | | |
|---|---|
| <ul style="list-style-type: none"> ■ ADVANTAGES: <ul style="list-style-type: none"> ■ Ease and cost of starting and ending the business ■ Secrecy ■ Flexibility and control ■ Pride of ownership ■ Distribution and use of profit ■ No special taxes – profits are “personal income” and taxed at individual tax rates ■ No government regulation | <ul style="list-style-type: none"> ■ DISADVANTAGES: <ul style="list-style-type: none"> ■ Unlimited liability. ■ Limited financial resources. ■ Limited skills pool ■ Overwhelming time commitment. ■ Few fringe benefits ■ Limited growth. ■ Limited life span. |
|---|---|

13

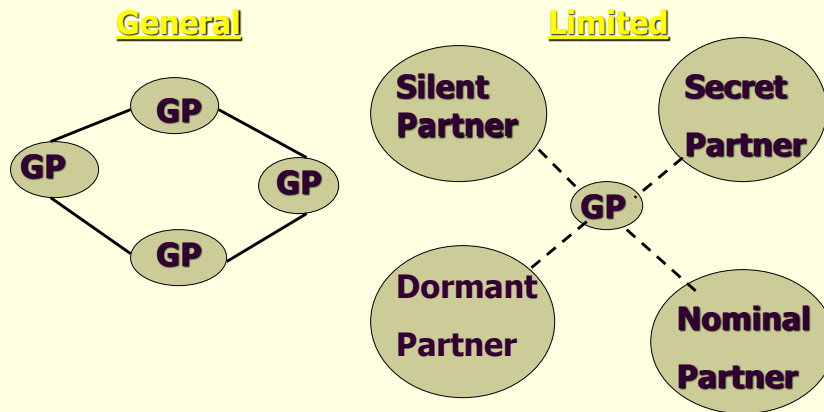
The Canadian Private Sector Forms of Business Ownership

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- **Partnership**
 - An arrangement whereby two or more persons combine some or all of their resources in a business undertaking with a view to sharing profits among partners
 - Provincial laws require that a partnership must legally register its name and give information about the partners

14

Types of Partnerships



15

General and Limited Partners

LIMITED PARTNERS

1. Silent Partners (known to the public, no active management role)
2. Secret Partners (unknown to the public, but take an active role in management)
3. Nominal Partners (lend their name for public relations, but actually not involved)
4. Dormant partners (neither known to the public nor active in management)

GENERAL PARTNERS

1. Senior Partners (major management roles, largest share of profits)
2. Junior Partners (minor management roles, smaller share of profits)

16

The Canadian Private Sector Forms of Business Ownership

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- **General Partnership – complete sharing in the management of the business**
 - Partners are not only liable in equal share for the debts of the partnership (jointly liable) but in addition, each partner is liable for the full amount (jointly and severally liable)
 - Each member can bind the partnership without consent of the other partners
- **Limited Partnership**
 - Composed of one or more general partners who conduct the business, and one or more persons who contribute an amount in actual cash (special or limited partners)
 - The special partner's liability is normally limited only to the amount of the cash s/he contributed to the partnership
- **Joint Venture**
 - Partnership established for a specific project or a limited time

17

Advantages and Disadvantages of Partnerships

Advantages

- Ease of organization
- More financial resources (capital and credit)
- Shared management
- Combined knowledge and skills
- Faster decision making
- Few regulatory controls

Disadvantages

- Unlimited liability
- Partners are responsible for the business activities of all others
- Division of profits
- Disagreements among partners – can be difficult to get rid of a partner
- Life of a partnership

18

The Canadian Private Sector Forms of Business Ownership

(Source of Information: Robert Sexty: Canadian Business in the New Stakeholder Economy, Prentice Hall Canada, 1998)

- A corporation is recognized as a **separate legal entity under the law**
- A corporation incorporated under the laws of Canada (a federally incorporated business) can carry on business in all parts of Canada
 - Federally incorporated businesses include 150 of the 200 largest corporations in Canada
 - A federal company cannot be prevented by a provincial government from exercising the powers that have been validly conferred on the company by federal authority (e.g., doing business in a province)
- **Governance of a corporation is the responsibility of a Board of Directors**
- **Ownership of a corporation is through stock or “shares”** – either “preferred” shares or “common” shares (typically the “voting” shares)

19

The Canadian Private Sector Forms of Business Ownership

(Source of Information: Robert Sexty: Canadian Business in the New Stakeholder Economy, Prentice Hall Canada, 1998)

- A Private Corporation:
 - The right to transfer shares is restricted
 - Number of shareholders limited to 50
 - May not sell shares or debentures (bonds or debt instruments) to the public
- A Public Corporation:
 - Sells shares to the public on a stock exchange
 - Is subject to stricter regulations for filing financial reports, must follow certain audit procedures
 - Must file a prospectus if shares are being sold to the investing public

20

The Canadian Private Sector Forms of Business Ownership

- A Subsidiary Corporation:
 - One that has the majority of its stock owned by another corporation known as the parent company (e.g., IBM Canada, Hewlett-Packard Canada)

- A Holding Company:
 - A corporation that controls one or more other corporations through ownership of their common stock

21

Advantages and Disadvantages of Corporations

Advantages

- More money for investment
- Limited liability
- Separation of ownership/mgmt.
- Ease of ownership change
- Perpetual life
- Size

Disadvantages

- Initial cost
- Paperwork
- Two tax returns
- Termination difficult
- Double taxation

22

Other Types of Corporations



- Non-profit - universities, hospitals, charities
- Cooperative – The Farmers COOP
- Crown Corporations – Export Development Corporation, VIA Rail

23

Other Types of Corporations – Non-Profit



- Non-profit - universities, hospitals, charities
- Focus more on providing a service than making a profit, but NOT owned by a government entity
- Funded through private donations and grants from government

24

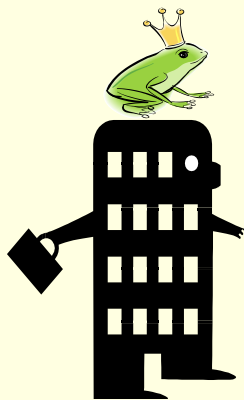
Other Types of Corporations – Cooperatives



- **A Cooperative or Co-op** – an organization composed of individuals or small businesses that have banded together to reap the benefits of belonging to a larger organization
 - Gay Lea – a Co-op of Ontario Dairy Farmers
 - Ocean Spray – a Co-op of cranberry farmers
- A Co-op is expected to operate without profit
- Pass savings on to members because the Co-op buys in bulk and advertising efforts are pooled

25

Other Types of Corporations – Crown Corporations



- **A Crown Corporation** – a “for profit” corporation owned and operated by the federal, provincial or local government whose focus is providing a service
- Operate in areas where the private sector either could not or would not operate because of high infrastructure or other costs:
 - **Mail delivery** in downtown and remote communities at the same cost
 - Areas where return on investment occurs only in the long-term (**Atomic Energy** and **Candu Reactors**)
 - Areas where the risk involved would make it necessary for a private sector organization to charge an unaffordable price (**Export Development Corporation**)
 - Areas where a service is intended to make all businesses more profitable (**Business Development Bank**)

The Canadian Private Sector Forms of Business Ownership

(Source of Information: Robert Sexty: Canadian Business in the New Stakeholder Economy, Prentice Hall Canada, 1998)

- The Family Business
 - About 2/3 of Canadian business enterprises are controlled by families (usually through private corporations)
 - It is estimated there are 10,000 family businesses in Canada with two or more generations as owners or managers
 - Family businesses control about 1/3 of the 100 largest companies in Canada
 - Founder or family members are in executive positions
 - Family members hold sufficient shares to make decisions and control operations
 - **Approximately 25% of family businesses survive the founder's demise; about 10% survive beyond two generations and 3% beyond the third generation**

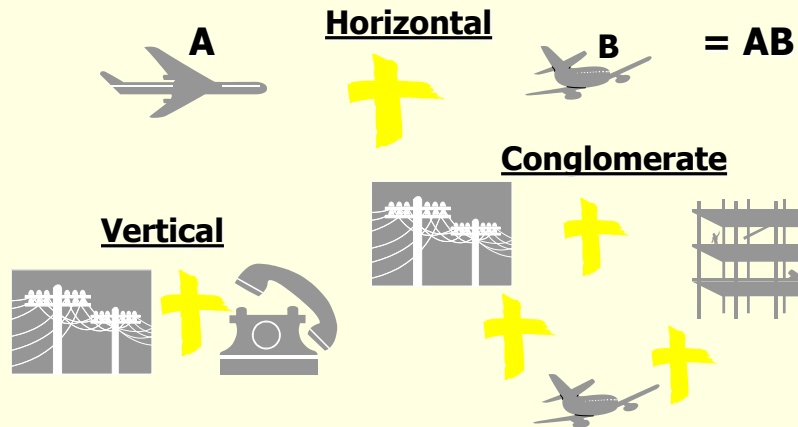
27

Corporate Expansion – Mergers, Acquisitions and Leveraged Buy-Outs

- **Mergers** - two or more companies join to form one company
 - **Vertical merger** - firms merge that are involved at different levels of the same business, i.e., Chrysler and a steel company
 - **Horizontal merger** - firms at the same level of the business merge, i.e., Chrysler and Daimler Benz
 - **Conglomerate Merger** – the merger of two firms in unrelated industries

28

Types of Mergers/Acquisitions



29

Corporate Expansion – Mergers, Acquisitions and Leveraged Buy-Outs

- An **acquisition** occurs when **one company purchases another by buying most of its stock**
- The acquired company may become a subsidiary or its assets may be merged
- The buying company gains control of the acquired company's assets but also assumes responsibility for its liabilities



30

Corporate Expansion – Mergers, Acquisitions and Leveraged Buy-Outs

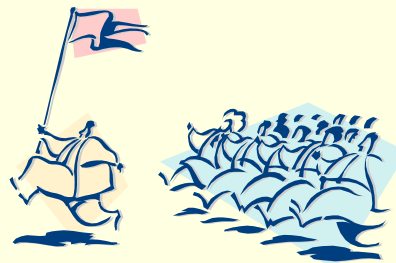
- A **leveraged buy-out** occurs when a group of investors borrows money from banks and other lending institutions to acquire a company, using the assets of the acquired company as security for repayment of the loan



31

Corporate Expansion – Mergers, Acquisitions and Leveraged Buy-Outs

- **Friendly vs. hostile take-overs**
 - Corporate raider offers to buy some or all of the company's stock at a premium over its current price
 - **Friendly** = both groups agree
 - **Hostile** = when the second company does not wish to be taken over



32

Corporate Expansion – Mergers, Acquisitions and Leveraged Buy-Outs



- Fending off a hostile takeover attempt:
 - **Ask shareholders** not to sell to the raider
 - File a **lawsuit**
 - **Poison pill** – allow shareholders to buy more shares of stock at prices lower than market value
 - **Shark repellent** – requiring a large majority of shareholders to approve the takeover
 - **White knight** – a more acceptable firm that is willing to acquire the threatened company

33

The Canadian Private Sector

- Over the last century the Canadian business sector has seen a shift from a system of enterprises more or less loosely connected by competition through the marketplace to a corporate system that now dominates the scene
- The distribution of business organizations in Canadian manufacturing industries has changed dramatically (from Sexty, Prentice Hall 1998):

	<u>% in 1950</u>	<u>% in 1980</u>	<u>% Today</u>
■ Sole proprietorships	45.6	11.5	2.4
■ Partnerships	15.0	3.3	0.5
■ Corporations	36.3	84.3	96.6
■ Co-operatives	3.3	0.9	0.5

34