

SAVVY ENTREPRENEURSHIP

4

Building the Framework

LEARNING OBJECTIVES

- Distinguish between informal and formal business structures
- Evaluate the advantages and disadvantages of various business structures
- Explain the importance of liability being matched to the business endeavor
- Recognize the tax implications of informal and formal business structures
- Discuss how to establish an LLC and a corporation
- Define small-, medium-, and large-sized businesses
- Differentiate between management structures
- Demonstrate respect for workplace and institutional authority

Business Structures: Options for Entrepreneurs

- The importance of structure: Your choice affects control, financial risk, taxes, and how easily you can raise money.
- Informal structures are simple to start and are not separate legal entities from their owners.
 - Sole proprietorship: There is one owner with complete control, income is reported on their personal taxes, and the owner has unlimited personal liability.
 - Partnership: Two or more owners share responsibility and skills; there's shared risk but unlimited personal liability for each partner.
 - Limited partnership: This includes general partners (who manage daily operations with unlimited liability) and limited partners (investors with liability limited to their investment).

Business Structures: Options for Entrepreneurs (cont.)

- Formal structures are legally registered separate entities that protect owners from personal liability.
 - Limited liability company (LLC): This balances flexibility with liability protection; it allows for "pass-through" taxation or election to be taxed as a corporation.
 - Corporation (C Corp): This is owned by shareholders who elect a board of directors, it can raise capital by selling stock, and it is subject to double taxation (taxed at corporate and dividend levels).
 - Cooperative (co-op): This is owned by members rather than stockholders, each member gets one vote, and it is focused on serving members rather than maximizing profit.
 - Franchise: This is a contracted business relationship using a proven model and brand standards, which reduces startup risk but requires ongoing fees and limits independence.

Key Factors to Evaluate

Evaluate choices based on:

- Control
- Risk
- Liability
- Taxes

Investigating Local Businesses

- The investigation process involves gathering evidence via websites, online listings, and in-person observation to determine a business's structure.
- Identification clues:
 - Look for designators like "LLC," "Inc.," or "Corp" in the name or website footer.
 - Check for "Investor Relations" links (indicates a corporation) or franchise branding.
 - Note if it is an independent single-owner shop or part of a national chain.

Management Structures and Workplace Culture

- Business Size: This is defined by revenue, employee count, and geographic reach.
 - Small: Typically fewer than 50 employees and under \$50 million in annual revenue
 - Medium: 50–1,000 employees and \$50 million to \$1 billion in revenue
 - Large: Over 1,000 employees and more than \$1 billion in revenue; often publicly traded

Management Structures and Workplace Culture (cont.)

- Common Management Structures:
 - Hierarchical: There's a clear pyramid structure with layers of authority.
 - Matrix: Employees report to both functional and project managers.
 - Functional: Employees are grouped by specialty (e.g., marketing, finance).
 - Divisional: Employees are organized by geographic area or product specialty.
 - Flat: This structure has minimal middle management and is typical for startups.
 - Network: This structure uses outsourcing and external partnerships.

Keys to Fostering a Strong Workplace Culture



Managing Risk and Liability

- Risk vs. liability
 - Risk: The chance of a problem occurring (injuries, equipment failure)
 - Liability: The cost/legal responsibility when something goes wrong
- Everyday liabilities: These include ongoing obligations like employee wages, supplier payments, taxes, and loan repayments.
- Protection: Formal structures (LLCs and corporations) protect personal assets like homes and savings by limiting liability to the assets of the business.

Business Taxes: File on Personal or Business Return?

- Pass-through entities: Income "passes through" the business to the owner's personal tax return (sole proprietorships, partnerships, most LLCs).
- Self-employment tax: Owners of informal structures typically pay around 15% on business earnings for Social Security and Medicare.
- Double taxation: This is unique to C Corporations and is when profits are taxed at the corporate level and again when distributed as dividends.
- It might be time to restructure if self-employment taxes are significant or if clients require a formal business structure to grant contracts.

Setting Up an LLC and a Corporation

- LLC requirements:
 - Select a unique name with an "LLC" designator.
 - Choose a registered agent.
 - File articles of organization.
 - Create an operating agreement to outline internal operations.
- Corporation requirements:
 - Choose a name that includes "Inc." or "Corp."
 - Issue stock.
 - File articles of incorporation.
 - Create bylaws.
- Compliance: Corporations often require annual filing of meeting minutes for board and shareholder meetings.

Setting Up an LLC and a Corporation (cont.)

REQUIREMENTS FOR THE ARTICLES OF INCORPORATION

- 1 Name of corporation**
- 2 Name/address of the registered agent**
- 3 Type of corporation**
Professional, C corp, profit, nonprofit
- 4 Names/addresses of the board of directors**
- 5 Number of shares issued**
- 6 Duration of the corporation**
Corporations can exist after the founders have left!
- 7 Name/address of the incorporator**
The one setting up the corporation

Professional Skills for Entrepreneurs

- Respect in the Workplace:
 - Listening
 - Providing positive reinforcement
 - Being transparent about mistakes
 - Maintaining professionalism during disagreements
- Respect for Institutions:
 - This includes compliance with government entities like the IRS, secretary of state, and local licensing boards.
 - The Free-Enterprise System: Respecting the rule of law and the U.S. Constitution creates a stable environment for innovation and business growth.

CHAPTER SUMMARY

- The choice of business structure impacts an owner's control, risk, liability, and taxes.
- Informal structures are easy to start but offer no protection for personal assets.
- Formal structures (LLCs/corporations) create a legal separation between the business and the owner, providing limited liability.
- Management structures (such as flat or hierarchical) organize internal communication and decision-making based on business size and goals.
- Risk management involves identifying the chance of problems (risk) and protecting the business from the resulting costs (liability).
- Professional respect for colleagues and government institutions is essential for long-term entrepreneurial success.