

Chapter 4

Legal Requirements



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Objectives

- 4-1** Discuss the process of legally naming a business.
- 4-2** Explain the nature of a sole proprietorship.
- 4-3** Describe the types of partnerships.
- 4-4** Name and define the five classifications of corporations.
- 4-5** Explain the benefits and disadvantages of a limited liability company.
- 4-6** Explain the Federal Trade Commission and its impact on advertising, pricing, product warranties, and competition.
- 4-7** List and explain the components of a legally enforceable contract.
- 4-8** List the employer's responsibilities for taxes, licenses, and employment regulations.

NAME THE BUSINESS LEGALLY

When the time comes to choose a name for the new business, certain basic principles apply. The name should be easy to spell, pronounce, and remember. It's best not to get too fancy. Fancy names can pose problems with spelling and pronunciation for customers. Sometimes the simplest name is the best choice.

When Sam Walton first started his franchise of five-and-dime stores, he called them "Ben Franklin." Most customers, however, referred to the stores as "Sam Walton's Five and Dime." Mr. Walton wanted a different name for his business. The name that would one day be associated with the biggest company in the world came about one day when Sam was flying with Bob Nogle, his first manager. During the flight, Sam proposed a number of new names.

Bob suggested they use something simpler, with fewer letters in it. He was thinking of the cost of big signs. He wrote W-A-L-M-A-R-T on a napkin and passed it to Sam, who was piloting the plane.

Mr. Walton read the suggestion but did not respond. To Bob's surprise, the next store opening featured a new Wal-Mart sign.

FUN FACTS

How do you think Hershey's Kisses got their name? No one seems to know for sure. One popular theory says the candy was named for the sound and motion of the chocolate being extruded during the manufacturing process.

Legal Requirements

Wal-Mart neglected to register the name immediately. By some accounts, it was 15 years before someone remembered to file for the registered trademark.

You may not be as lucky as Wal-Mart in protecting the name of your new business. After you decide on a name, you should find out if state law requires that you register it. Registration requirements differ from state to state, but there are many similarities. For instance, all companies doing business in Colorado with trade names must register those trade names. Sole proprietorships and general partnerships must register their trade names with the Department of Revenue. According to state law, a **trade name** is any name other than the full first and last name(s) of the owner(s) of a business entity, including a general partnership. Under this law, the following are trade names:

- John Doe's Plumbing Supply
- Jane Doe's Chiropractic Clinic
- Joe Doe & Associates
- Jane Doe's Accurate Accounting

The following are not trade names:

- John Doe, Plumber
- Jane Doe, Chiropractor
- John Doe, Attorney at Law
- Jane Doe, CPA

If you are in doubt about whether or not you have to register your business's name, either contact the Secretary of State's office or consult an attorney. Failure to register a trade name could result in the loss of your right to use it.



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FORMS OF OWNERSHIP

A key decision for any entrepreneur is one of ownership of the new business. Will you choose to make a go of it by yourself? Will you establish a business with one or more other people? Or do you want a business in which many people share ownership?

The form of ownership an entrepreneur chooses has important legal, financial, and personal implications throughout the life of the business. Each form has advantages and disadvantages. As you read through this chapter, keep in mind the type of business you would like to start someday, and try to determine which form of ownership is right for you.

The four basic forms of business ownership are sole proprietorship, partnership, corporation, and limited liability company. Which of these is best for the entrepreneur thinking of starting a new business?

SOLE PROPRIETORSHIP

Do you want to go it alone? If you are willing to be solely responsible for all aspects of a new business, a sole proprietorship may be the best form of ownership for you. A **sole proprietorship** is a business

established, owned, and controlled by a single person.

Sole proprietorships come in all shapes and sizes. They may be very small businesses with only one employee, the owner. A sole proprietor may hire a manager to run the business on a daily basis or may own a very large business with hundreds of employees. The owner realizes all the profits from the business and assumes responsibility for all losses. In this sense, the owner of a sole proprietorship is truly an entrepreneur.

The sole proprietorship is the most prominent of the four forms of ownership. In fact, more than 95 percent of all businesses in the United States are sole proprietorships. They are easy to form and allow almost unlimited control of the business. The same characteristics that prompt individuals to be entrepreneurs—the desire to control their own destiny, the freedom from direct supervision, and the potential to achieve profits greater than a salary from someone else—prompt them to choose the sole proprietorship form of ownership.

Formation of a Sole Proprietorship

Of the four forms of ownership, the sole proprietorship is by far the easiest to form. The government exercises very little control over the establishment of new sole proprietorships. Start-up can be immediate and simple, providing you have all the necessary resources—capital, knowledge, and merchandise or a service to sell. Keep in mind that you may need to

obtain licenses or permits for your particular type of business, such as the license to operate a hair salon.



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Operation of a Sole Proprietorship

Sole proprietors make all the decisions regarding the operation of the business. Although they have the luxury of being the boss, sole proprietors are not exempt from financial risk. They must obtain the necessary funds to open and run the business, and they must pay taxes.

The assets of sole proprietors are not considered legally separate from the assets of the business. This means that if the business does not succeed and any debts remain, the proprietor's assets may be taken to pay those debts. Despite this drawback, reporting taxes is fairly simple. Owners of sole proprietorships report business income and expenses on their personal income tax returns.



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Advantages and Disadvantages of a Sole Proprietorship

To summarize, some of the advantages of a sole proprietorship are as follows:

- Sole proprietorships are simple to start. No formal action is required.
- A sole proprietorship may be started immediately.
- The owner has total control of all aspects of the business.
- The owner receives all the profits.
- The business itself pays no income tax; the owner pays income tax as an individual.

A sole proprietorship also has some disadvantages:

- The owner has unlimited responsibility for losses, debts, and other liabilities the business might develop.
- The owner must make all the decisions.
- The owner is the only person who can arrange financing or capitalization.
- The existence of the business ends upon the owner's death.

Federal Tax Forms for Sole Proprietorships

The following is only a partial list of tax forms, as listed on the SBA Internet site, and some may not apply to your business.

- Form 1040: Individual Income Tax Return
- Schedule C: Profit or Loss from Business (or Schedule C-EZ)
- Schedule SE: Self-Employment Tax
- Form 1040-ES: Estimated Tax for Individuals
- Form 4562: Depreciation and Amortization
- Form 8829: Expenses for Business Use of Your Home
- Employment Tax Forms



Small Business Technology

It is important to protect the name of a new business through registration. Part of any registration process is a search to determine if the name is already in use. Both the name search and name registration can be accomplished in most states using the Internet. The best place to start is the Secretary of State's home page. A process that used to take weeks can now be completed in minutes.



PARTNERSHIP

As defined by the Uniform Partnership Act (UPA), a **partnership** is an association of two or more persons to carry on as co-owners of a business for profit. Partners with complementary skills or knowledge often team up to form a partnership. For example, a person experienced in manufacturing may form a partnership with an individual with marketing expertise. Partnerships offer the benefit of combined finances as well as combined talents.

The Uniform Partnership Act has been adopted by almost every state to provide a degree of uniformity to partnership laws. Entrepreneurs should check to see if the UPA has been adopted by the state in which their new business is to be located. If it has not, they should approach the formation of a partnership more cautiously. Without the UPA, there are no guidelines to protect individuals in partnerships.

Partnership Agreement

One of the first things that must be done when two or more entrepreneurs are considering a partnership arrangement is to write a **partnership agreement**, such as the one in Figure 4–1 on page 69. Written partnership agreements are not required by law in all partnerships; oral agreements are perfectly legal in some cases. However, a written agreement is

strongly recommended. Many future conflicts can be avoided by defining in writing all important aspects of the partnership. At a minimum, partnership agreements should contain the following points:

- Name of the business or partnership
- Names of the partners
- Type of investment of each partner (such as cash, equipment, real estate) and its value
- Managerial responsibilities of each partner
- Accounting methods to be used
- Rights of partners to review and/or audit accounting documents
- Information about how profits will be divided and how losses will be shared
- Salaries/money to be withdrawn by partners
- Duration of the partnership
- Information concerning dissolution of the partnership
- Distribution of assets upon dissolution
- Procedure relating to the death of a partner

FIGURE 4-1*Partnership Agreement*

PARTNERSHIP AGREEMENT

We, L. J. Doray, Jake Meyer, and Janet Feldman, do mutually agree to conduct a business as general partners under the fictitious trade name of STYLE 'N SPEED, on the following terms and conditions:

- PURPOSE, LOCATION I The purpose of the business shall be the operation of an automobile body customizing shop to be located in rented quarters at 5500 Auto Row, Atlanta, Georgia.
- DURATION, DISSOLUTION II The partnership shall continue for a period of five (5) years, with the expectation that it will be renewed thereafter for additional five-year periods by unanimous mutual consent. However, any partner may withdraw without liability with ninety (90) days' notice in writing, sent by registered mail to the other partners, with time to commence five (5) days from date of posting. In such event, either or both of the other partners may decide to terminate the business. In the alternative, either or both may elect to continue the business, buying the interest(s) of the withdrawing partner(s) at book value with no allowance for goodwill. Book value shall be determined as of the date of withdrawal, by the firm's certified public accountant. Payment shall then be made in equal monthly installments over a three (3) year period, unless otherwise agreed, with interest at ten (10) percent a year on the unpaid balance. The continuing partner(s) may accelerate the payments at will. In the event of death of any partner, the same terms shall apply.
- CAPITAL III The initial capital shall be the sum of thirty thousand dollars (\$30,000) to be contributed in equal amounts by the partners within ten (10) days of this agreement. Additional contributions of no more than ten thousand dollars (\$10,000) from each partner may be required by majority vote at any time within one year from this date. Any further contributions of capital shall require unanimous agreement.
- DUTIES, AUDIT, BANK IV Doray and Meyer shall work in the shop; Feldman shall run the office, promote sales, make all necessary purchases and disbursements, and keep or supervise...
...fiscal year by allocating the year's total profit to all working days equally. Any sum thus deducted shall be added to the share of profits of the partner(s) who remained at work on the day(s) in question.
- COMMENCEMENT, WORK DAYS VII Business shall commence on the day this agreement is signed. The work of this partnership shall constitute the full-time, gainful occupation of each of the partners. Unless and until otherwise agreed, the business shall be open from 8:00 a.m. until 6:00 p.m. every weekday. It shall be closed on Saturdays, Sundays, and officially designated federal holidays.

IN WITNESS WHEREOF WE HAVE SET OUR HANDS THIS
_____ day of September, 20--.

L. J. Doray *Jake Meyer* *Janet Feldman*
L. J. Doray Jake Meyer Janet Feldman

Types of Partnerships

Partnerships may take many forms, but the general partnership and the limited partnership are the most common. Entrepreneurs should be familiar with the characteristics of each.



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General Partnership A general partnership is made up of two or more general partners. A **general partner** is a partner who actively engages in the day-to-day management of the business and is fully liable for any actions for, by, and against the business. General partners are sometimes referred to as “ordinary” or “regular” partners. Partnership agreements are not always required by law for this type of partnership. They are, however, advisable.

Limited Partnership A limited partnership is made up of one or more general partners and one or more limited partners. A **limited partner** is a partner who does not actively engage in the day-to-day

management of the business and whose liability is limited to the extent of his or her investment in the business. Limited partners are investors in the business. For example, if Marty Junkin wants to be a limited partner in Dana Simpson’s video store business, she is limited in two ways. First, Marty cannot participate in the day-to-day management of the video store. Second, her liability is limited to the amount she invests in the business. If she invests \$3,000, then \$3,000 is the maximum amount she can lose.

In a limited partnership, there must be at least one general partner. This means that at least one partner in the business is both fully liable for losses and involved in the daily management of the business.

Unlike a general partnership, which has minimal start-up requirements, there must be a partnership agreement in a limited partnership. States generally require that the limited partnership agreement be filed with the state in which it is located. Entrepreneurs forming a limited partnership should seek the assistance of a competent attorney when writing and filing the agreement.

Termination of a Partnership

A partnership may be terminated for any number of reasons. Partners may agree to terminate the partnership. A partner may leave or a partner may be added, in which case the old partnership is terminated and a new one initiated. A partnership agreement may provide for the expulsion of partners under certain circumstances, such as the unauthorized use of funds.

The law also dictates the termination of partnerships under certain circumstances. These include the death, bankruptcy, or insanity of a partner. In addition, a partnership may be terminated if the purpose of the business is determined to be illegal.

Advantages and Disadvantages of a Partnership

There are numerous advantages for the partnership as a form of ownership.

- Start-up can be simple because the law does not always require a partnership agreement.
- The partnership, as an entity, pays no income tax.
- Partners share the responsibilities of decision making, management, and capitalizing the business.
- Partners share any and all liabilities.
- Liability is limited in the limited partnership.

There are also disadvantages to partnerships:

- A high percentage of partnerships are terminated.
- General partners carry unlimited financial liability (in the general partnership).
- Each general partner carries liability for the errors of his or her partners.
- Because decision making and management are shared, partners have potentially less control.
- Partners must share profits.
- Partnership termination may disrupt business.

Federal Tax Forms for Partnerships

This is only a partial list of tax forms, taken from the SBA Internet site, and not all may apply.

- Form 1065: Partnership Return of Income
- Form 1065 K-1: Partner's Share of Income, Credit, Deductions
- Form 4562: Depreciation
- Form 1040: Individual Income Tax Return
- Schedule E: Supplemental Income and Loss
- Schedule SE: Self-Employment Tax
- Form 1040-ES: Estimated Tax for Individuals
- Employment Tax Forms



CORPORATIONS

A **corporation** is a legal entity created by law. In some ways a corporation is like an artificial person. For example, a corporation pays taxes, accrues debt, enters into contracts, can be held liable for negligence, and can make a profit.

Starting a Corporation

A corporation is created by one or more people. The individuals who start the process of incorporation—creating the corporation—are called promoters. The promoters file articles of incorporation with a state agency, usually the Secretary of State. Typically, articles of incorporation must contain the following information:

- Name of the proposed corporation
- Promoters' names and addresses
- Address of the corporate office
- Explanation of why the corporation is being formed
- Number of years desired for operation of the corporation (most states allow an indefinite number)
- Names and addresses of the people who will direct the corporation

Once the articles of incorporation are in order, the promoters pay the required state fees, which vary from state to state. When all requirements have been met, a state official—again, usually the Secretary of State—issues a charter. Entrepreneurs should have an attorney file all papers.



Ownership and Management of a Corporation

Ownership of corporations is handled through the possession of stock. **Stock** represents a share of ownership in a corporation. The promoters and/or executives of a corporation divide a specified amount of stock into a certain number of shares. People who buy these shares are called **shareholders** or **stockholders**. All shareholders hold partial ownership in the corporation, according to the amount of stock they own.

The amount of ownership represented by one share of stock is determined by the amount of stock issued upon incorporation. If 1,000 shares of stock are initially issued, each share represents 1/1,000 ownership of the corporation. If the initial issue is 50,000 shares of stock, each share represents 1/50,000 ownership. The greater the number of shares issued, the lower the value of each share.

After the charter has been issued for a new corporation, a shareholders' meeting is held. Any person owning stock in a company has the right to attend and vote on issues during this and all future meetings. During the first meeting, a board of directors is elected. The board is responsible for electing the senior officers of the corporation, setting their salaries, and deciding the corporation's rules for conducting business.

Classifications of Regular "C" Corporations

Corporations are usually classified in five categories: domestic, foreign, public, private, and closely held.

Domestic or Foreign A corporation doing business within the state of incorporation is referred to as a domestic corporation. When employees of the corporation go out of the home state to do business, the corporation is considered a foreign corporation in the other states in which it does business. As an example, consider Leonard, Inc., a business that sells musical greeting cards. It is incorporated in the state of North Carolina. When it does business in North Carolina, it is a domestic corporation. When it does business in Texas, or any state other than North Carolina, it is a foreign corporation. Foreign corporations sometimes need to obtain permission to do business in other states.

Public or Private

Corporations can be either public or private. Public corporations are incorporated government entities. For example, public utility companies fall into this category.

A private corporation is one owned by one or more individuals. As a rule, it is freer to operate than public corporations because it is bound by fewer regulations. Entrepreneurs who choose to incorporate form private corporations.

Closely Held Closely held corporations are similar to private corporations. Closely held corporations are private; the difference is that stock is sold to people other than the promoters, but only on a small scale. Even though the corporate structure is used and shares of stock are issued, there is nothing in corporate law that requires large-scale or public sale of the stock. The promoters may choose to retain all or most of the stock themselves. Some notable examples of closely held corporations are Mary Kay Cosmetics and the Amway Company.



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Subchapter S Corporations

A popular variation, the subchapter S designation must be requested from the IRS by the stockholders. Once requested, it becomes a tax election only. This means it still has all the advantages of a corporation but is taxed differently. It eliminates double taxation by enabling shareholders to treat the earnings and profits as distributions and have them pass directly to their personal tax returns. This eliminates double taxation.

Advantages and Disadvantages of a Corporation

Because of their legal structure, corporations offer numerous advantages.

- **Limited Liability** This is probably the primary reason many entrepreneurs choose the corporate form of ownership. In many ways it is less risky than other forms. Shareholders' liability for debts, taxes, and lawsuits is limited to the amount of money they have actually invested in the purchase of stock. However, you should be aware that most lenders require a top executive of an incorporated small business, such as the chief executive officer (CEO), to sign both personally and as the business owner. In such cases, liability may not be limited for that individual.
- **Ability to Raise Capital** The ability of a corporation to raise additional capital through the sale of stock is a very important advantage of this form of ownership. Lenders are generally more willing to loan money to corporations than to sole proprietorships or partnerships.
- **Continuity of Business** Unlike the sole proprietorship and partnership, the corporation is not directly affected by events such as the death or bankruptcy of an owner. The business continues to exist and operate regardless of what happens to individual shareholders.
- **Transferable Ownership** Since shareholders (owners) do not manage the business, ownership can change through the buying and selling of stock without disrupting the day-to-day business of the corporation.

The legal structure of the corporation can also lead to disadvantages.

- **Double Taxation** There are several instances in which individuals are taxed more than once on income generated from a corporation. Functioning as a legal entity, the corporation pays income tax on profits earned. Shareholders pay additional income tax on any dividends they receive from the corporation. Employees who are shareholders must, of course, pay income tax on their salaries, so they are taxed one more time. This is a disadvantage, especially for a closely held corporation.
- **Charter Costs** The cost to incorporate a business can be high. Attorneys can be expensive, and fulfilling state requirements generally involves paying fees.
- **Regulation** A corporation is subject to a considerable amount of regulation that does not apply to the sole proprietorship or partnership. Examples include holding board meetings, keeping records of board meetings, and completing public disclosure reports. A corporation's business activities are also regulated; it may pursue only the business activities stated in the charter. If the owners wish to expand those activities or do business in other states, they must complete the necessary paperwork first.



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- **Lack of Control** Ownership in a corporation does not guarantee any control or say in the day-to-day operation of the business. Remember, stockholders only vote for the board of directors. The president or CEO actually decides how the business is run. Even if you are a major stockholder, unless you are the president or CEO you may not have much control over the management of the company.

Federal Tax Forms for Corporations

Federal tax forms for regular “C” corporations (as listed on the SBA Internet site) include:

- Form 1120 or 1120-A: Corporation Income Tax Return
- Form 1120-W: Estimated Tax for Corporation
- Form 8109-B: Deposit Coupon
- Form 4625: Depreciation
- Employment Tax Forms
- Other forms as needed for capital gains, sale of assets, alternative minimum tax, etc.

Federal tax forms for subchapter S corporations include:

- Form 1120S: Income Tax Return for S Corporation
- 1120S K-1: Shareholder’s Share of Income, Credit, Deductions
- Form 4625: Depreciation
- Employment Tax Forms
- Form 1040: Individual Income Tax Return
- Schedule E: Supplemental Income and Loss
- Schedule SE: Self-Employment Tax
- Form 1040-ES: Estimated Tax for Individuals
- Other forms as needed for capital gains, sale of assets, alternative minimum tax, etc.



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LIMITED LIABILITY COMPANY

A **limited liability company (LLC)** is an alternative form of ownership that has been around since the late 1980s. It has become a very popular form of ownership for small business owners. It offers the limited liability protection of a corporation but is taxed like a partnership.

Advantages and Disadvantages of an LLC

Forming an LLC has several benefits:

- It has limited liability.
- It is taxed like a partnership.
- It is not subject to all the rules involved in an S corporation.

LLCs have certain drawbacks as well:

- The body of case law around this form of ownership may not be fully developed.
- The type of businesses may be limited by state law.
- A single owner usually cannot establish an LLC.
- Many states limit the life of an LLC to 30 years.

As with a corporation, different versions of the LLC are available in different states. In Colorado, for instance, the entrepreneur may choose an LLC, a limited liability partnership, or a limited liability limited partnership.

Federal Tax Forms for LLC

The LLC is taxed as a partnership in most cases.

TABLE 2-1 COMPARE FORMS OF OWNERSHIP

Factors of Ownership	Sole Proprietorship	Partnership	Corporation	Subchapter S	Limited Liability Company (LLC)
Ease of start-up	A	A (except limited)	D	D	D (depends on state)
Liability	D	D (except limited)	A	A	A
Regulation	A	A (except limited)	D	D	D (depends on state)
Ownership control	A	A (except limited)	D	D	A
Initial costs	A	A	D	D	A (depends on state)
Ability to raise capital	D	A	A	A	A
Taxes	A	A	D	A	A
A Advantage of this particular form of ownership D Disadvantage of this particular form of ownership					

SPECIAL REGULATIONS

There is more to successfully operating a business than hanging a sign and opening the door. You have examined the process of naming the business and the different forms of ownership. Now it is time to look at some legal considerations.

As an entrepreneur, you will enjoy considerable freedom to operate your business as you see fit. This freedom may be somewhat restricted, however, by certain laws and regulations. To prevent costly lawsuits and other unpleasant matters, you should understand certain basic laws that regulate business activities.

FEDERAL TRADE COMMISSION

The **Federal Trade Commission** (FTC) is a federal administrative agency charged with the responsibility of ensuring fair, free, and open business. In general, it is concerned with unfair business practices in interstate commerce. Its scope is very wide, affecting advertising, consumer credit, product safety, and business competition.

The FTC accomplishes its job in several ways. It interprets laws and creates regulations. It also advises businesses when it is requested to do so. If unfair business practices are suspected, the FTC will investigate. Based on its findings, it may issue “cease and desist” orders, and businesses can then voluntarily discontinue unfair, deceitful, or illegal business practices. If a business does not agree to stop such activities, the FTC may prosecute. As you read about some of the FTC’s major areas of responsibility—advertising, pricing, product warranties, and competition—in the following paragraphs, think about which ones might apply to the business you would like to start.

Advertising

The FTC’s role in advertising is to ensure that accurate information is being presented in advertisements to the public. Being accurate is not enough, though. The information must also be presented in a way that is not misleading. The following are some circumstances in which the FTC might take an interest in the advertising methods of a small business.

False Advertising False advertising is any advertising containing information that is not true or would cause the average consumer to reach a false conclusion about the product or service concerned. For example, if marketers of products containing oat bran claim that oat bran lowers cholesterol levels, it must be a proven fact. Otherwise, they are engaging in false advertising.

Deceptive Advertising Deceptive advertising is any advertising containing information that would mislead the average consumer about a particular product or service. Marketers presently advertise many foods as “diet” by virtue of “low fat” content. In fact, the products may actually contain a very high calorie count. Many consumers consider this to be deceptive advertising.

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FUN FACTS

H. J. Heinz created the “57 varieties” tag line in 1896 as a marketing ploy. At the time, the condiments company was producing well over 57 different products. He simply liked the way “57” looked on a sign.

Billie's Steppin' Out Shoes

*Lowest Prices
In Town!*



BRAND NAME SNEAKERS
Hours 10 – 8 Mon thru Fri
401 Dodge Road

Prior to the establishment of the FTC in 1914, false and deceptive advertising were fairly common. Since then they have become less common, but they have not disappeared altogether.

There is a fine line between false advertising and deceptive advertising. For example, consider Billie's Steppin' Out Shoes. Billie's sales have been lower than normal for the past month. She has decided that a little advertising is what she needs to pump some life back into her business. In her newspaper ad is an illustration of a popular, national brand-name sneaker. The caption indicates that Billie offers these shoes at the lowest price in town. In reality, Billie has not checked prices outside her own shopping area. She has no idea what the sneakers cost at the mall across town. Billie has just engaged in false advertising. Her claim of offering the sneakers at the lowest price in town is just a claim. She does not know whether it is true or not. Her reason for making the claim is to entice customers into her store.

Now consider Billie's competitor, the owner of Frank's Fine Footwear. Seeing Billie's ad, Frank decides to fight back. He places an ad in the newspaper with this statement: "BRAND-NAME SNEAKERS FOR SALE. SNEAKERS PRICED AT \$10." Frank thinks he is being smart. What he says is true. He does have brand-name sneakers for sale and he does have some sneakers for \$10. They are not the same sneakers, however. Therefore, Frank has engaged in deceptive advertising. The average consumer would probably assume that the brand-name sneakers are priced at \$10. Both Billie and Frank have broken the law and are subject to penalties prescribed by the FTC.

Bait and Switch Advertising The practice of advertising a lower-priced item to lure customers into the store for the real purpose of selling them a different, higher-priced item is called **bait and switch advertising**. With bait and switch, an actual attempt is made to convince the customer that the advertised product is inferior and should be ignored in favor of higher-priced merchandise. As an example, take Frank's advertisement for \$10 shoes. His ad lures customers in. The "bait" is the inexpensive shoes. If Frank tries to "switch" the customer's preference from the lower-priced sneakers to higher-priced brand-name sneakers, he has engaged in bait and switch advertising. Again, he will have violated the law.

Sometimes salespeople claim that all the advertised models have been sold, when in fact the items were never in stock in the first place. This practice is often difficult to prove, especially if the store later has the advertised product in stock.



The Global **ENTREPRENEUR**

When businesses advertise to children 12 and under in the United States, the FTC pays particular attention because children may be more vulnerable to certain kinds of deception. Advertising directed to children is evaluated from a child's point of view, not an adult's.

To monitor the ads, the FTC works with the Children's Advertising Review Unit (CARU) of the Council of Better Business Bureaus. The advertising community established CARU to serve as an independent manager of the industry's self-regulatory program. CARU publishes self-regulatory guides for children's advertising.

In summary, advertising to children in the U.S. is self-regulated, with little legislation to enforce it. Entrepreneurs should realize, however, that other countries regulate advertising to children through laws.

As an example, Sweden, commonly seen as the strictest European country in this area, bans advertising aimed at children under 12 and does not allow advertisements before or after children's TV programs. Swedish public opinion considers advertising to children "not fair play." The law also prohibits displays of sweets in shops within reach of little children. Additionally, it is against the law to address direct marketing mail to children under 16.

A number of other European countries have also tightened their rules concerning marketing to children. Greece, for example, bans all toy advertising on TV between 7 A.M. and 10 P.M.

Global entrepreneurs should carefully investigate local laws before advertising in another country. Failure to do so could have serious legal consequences.

Think Critically

Pick a member country of the European Union and investigate its advertising laws. Are they significantly different from U.S. laws?

Deceptive Pricing

You have probably noticed that many stores—especially some major chains—always seem to be having sales. These repeated sales have attracted the attention of the FTC because of a concern that the advertised sale price is actually the true value of the merchandise, not a reduction from the original price.

As an example, imagine that Merchandise for America is a large general merchandise company found in malls across the country. Because it has so many stores, it can go directly to a factory and have clothing made exclusively for its stores. Recently, Merchandise for America had the factory make 20,000 swimsuits for the summer season. The swimsuits have a retail value of \$20 each. The company had the factory put a price tag on each suit listing the suggested retail price at \$30.

In a memo to store managers, a store executive instructed them to put the swimsuits on sale after displaying them for only one week. If the FTC investigated this, it would probably conclude that the pricing was deceptive. The only reason the price was originally set at \$30 was so that it could be marked



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at a sale price. The lower price would deceive customers into thinking they were getting a bargain when, in fact, they were not.

For entrepreneurs unsure about the legalities of pricing, the Federal Trade Commission offers an excellent publication, *FTC Guides Against Deceptive Pricing*. It is written in plain English, easy to understand, and offers excellent examples illustrating the basics of pricing regulations.

Product Warranties

Generally speaking, a warranty is a guarantee of the integrity of a product. Entrepreneurs need to be aware of two types of warranties—express and implied.

Express Warranty An **express warranty** is a clearly stated fact, either written or verbal, about the quality or performance of a product. For example, a label on a sweater saying “100 percent cashmere” is an express warranty. The warranty often serves as an important factor in a consumer’s buying decision.

Entrepreneurs must exercise caution when purchasing goods from suppliers. They need to judge whether or not the products can deliver what their manufacturers or their labels state they can. Furthermore, business owners and their salespeople must watch what they say about product performance or quality when talking to customers. If they are not careful, sales talk may become an enforceable warranty.

As an example, consider Barbara Ellis. She works at Mountain Products Limited, a sporting goods store. A customer, Mary, enters the store and wants to look at sleeping bags. During her sales pitch, Barbara says, “I guarantee that this bag will keep you warm even if the temperature drops to 30 degrees below zero.” Whether the bag was designed for that temperature or not does not matter: Barbara has issued an express warranty. The store can now be held liable if the product fails to protect the buyer at minus-30 degrees. This bit of sales talk can ultimately be costly to the store if it is not true. The salesperson should never warranty a product in any way that is not supported by the manufacturer.

Implied Warranty Almost all purchases are covered by implied warranties. They are created by state law, and all states have them. An **implied warranty** is an unwritten warranty ensuring that a product will perform under normal use and circumstances. In other words, the consumer is entitled to certain minimum levels of quality when purchasing products.

As an example, a customer purchases from your retail store a radio designed for use in the shower. The first time the buyer uses the radio, it stops playing as soon as it gets wet. Since the radio was designed to be used in the shower, getting it wet would be considered normal use. Therefore, based on the implied warranty, the customer can legally return the radio to your store and get a replacement.



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If the purchase does not come with a written warranty, it is still covered by implied warranties unless the product is marked “as is,” or the seller otherwise indicates in writing that no warranty is given. Several states, including Kansas, Maine, Maryland, Massachusetts, Mississippi, Vermont, West Virginia, and the District of Columbia, do not permit “as is” sales.

FTC’s Role in Warranties The FTC is charged with enforcement of the Magnuson-Moss Warranty Act, which provides standards for companies that choose to give written express warranties on consumer products. Under the FTC’s Disclosure Rule, five basic components of warranty coverage must be described.

1. What does the warranty cover? What does it not cover? If there are exclusions or exceptions, you must state specifically what they are.
2. What is the period of coverage? If coverage begins at some point in time other than the purchase date, your warranty must state the time or event that begins the coverage. One example is when the warranty coverage begins upon product installation, which may be different from when the product is purchased. Also, if coverage is terminated by a particular event, that must be clearly stated. For instance, coverage might last until the first purchaser transfers the product to someone else.
3. What will you do to correct problems? You must explain what remedy you offer under the warranty. This could be repair or replacement of the product, a refund of the purchase price, or credit toward subsequent purchases.

If necessary for clarity, you must also explain what you will *not* do—the types of expenses, if any, that you will not cover. These might include labor charges, consequential damages (the costs of repairing or replacing other property that is damaged when the warranted product fails, such as food that spoils when a refrigerator breaks down), or incidental damages (the costs a consumer incurs in order to obtain warranty service, such as time lost from work or charges for towing, telephone calls, transportation, or renting a product to temporarily replace the warranted product).

4. How can the customer get warranty service? Your warranty must tell customers whom they can go to for warranty service and how to reach those persons or companies. The warranty must include the name and address of your company and any person or office customers should contact.
5. How will state law affect your customer's rights under the warranty? Your warranty must answer this question because implied warranty rights and certain other warranty rights vary from state to state. Rather than require a detailed explanation on a state-by-state basis, the FTC adopted the following boilerplate disclosure, which must be included in every consumer product warranty: "This warranty gives you specific legal rights, and you may also have other rights which vary from state to state."



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Competition

The FTC guarantees fair competition among U.S. businesses through the enforcement of the Sherman Antitrust Act, the Clayton Act, and the Robinson-Patman Act. Sometimes, however, a business may do something that does not violate one of these acts but still interferes with fair competition. The FTC can step in if a valid complaint is filed. As an example, consider a bank that wants to increase its deposits. As an incentive, it offers an interest rate that is a full percentage point higher than the rate other local banks are offering. Consumers who want to earn this higher rate, however, must agree to do all their banking business with this particular bank. The bank is not violating any antitrust laws, but it is still trying to interfere with fair competition. The FTC has the authority to step in and investigate.

CONTRACTS

Entrepreneurs deal with contracts and agreements—both formal and informal—on a daily basis. These contracts take many forms and address a wide range of situations. Because of the variety—and potential complexity—of contracts, it is important that entrepreneurs understand the basic principles by which contracts and agreements operate.

Contractual Requirements

A **contract** is a legally enforceable agreement negotiated between two or more persons. A "person" may be either a juristic person or a human being. A juristic person is an entity, such as a corporation, created by law. A legally enforceable contract fulfills requirements in five areas:

- agreement (offer and acceptance)
- legality
- consideration
- contractual capacity
- contractual form

Agreement (Offer and Acceptance)

A contract must provide for an offer by one party and an acceptance by another. This is not as simple as it sounds. Certain requirements must be met for the offer and for the acceptance.

Offer A contractual offer is an offer that is intended to be legally binding. The intent is judged to be legally binding if a reasonable person would consider it binding.

Marty, a salesperson, is taking a client to lunch and her car won't start. She says, "I'd sell this thing for two cents. It's no good." Marty is angry; she wouldn't really sell her car for two cents. This is not an offer in the legal sense.

Marty calls her friend Bill and says, "I'm buying a new car. Would you like to buy my old one for fifteen hundred dollars?" Marty really wants to sell her car. An offer has been made in the legal sense.

The offer must also be in definite terms and communicated in some ordinary fashion. In the second example above, Marty made a definite offer—the sale of her car. Marty also communicated the offer to Bill in an ordinary fashion—verbally.

Once communicated, the offer does not remain open forever. It may be ended in several ways:

1. The party making the offer retracts it prior to acceptance.
2. The party receiving the offer rejects it. Once the offer is rejected, the party that rejected it cannot later demand that the offer be honored.
3. The party receiving the offer makes a counteroffer. The original offer is ended and a new offer exists. In the second example above, Bill might tell Marty that he will give her \$1,000 instead of \$1,500. At that point, the original offer is ended and replaced by the second.
4. An offer ends after the passage of a reasonable length of time.
5. The death or mental incapacity of either party ends an offer.
6. Any change in a law that makes an offer illegal ends an offer.

Hector offers to sell a three-wheeled recreational vehicle to Tom for his customers at the hotel to use. After the offer has been made, a law is passed that makes it illegal to drive a recreational vehicle with less than four wheels. The offer is now illegal and, therefore, ended.

Acceptance An acceptance must be clear and positive. The party accepting an offer must agree unconditionally to all the terms of the offer. The acceptance may be communicated to the party making the offer in any fashion unless a specific method of acceptance is designated. If, however, the acceptance is not communicated in a manner equal to or better than that of the communication of the offer, the acceptance is not effective until thus received.

Marty writes Bill a letter offering her car for sale. Bill writes back accepting the offer. His acceptance is effective when he mails the letter. Marty cannot change her mind, even if she has not yet received the letter.



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Legality

A legally enforceable contract must have a lawful objective. If the satisfaction of a contract requires breaking the law or violating a statute or policy, it does not have a lawful objective.

Jo tells Ben she will use her employee discount at a retail computer store to buy a computer for his new clothing store if he'll sell her two new outfits at cost. Since the discount is intended for Jo's personal use and is not transferable, the contract does not have a lawful objective and is not enforceable.

Consideration

Each of the parties involved in a contract must receive value. The legal term for that value is **consideration**. Think back to the first example.

If Bill accepts Marty's offer, the consideration (value) to Marty is Bill's \$1,500, and the consideration to Bill is Marty's car.



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Contract law does not require that the considerations be equal. Marty's car may be worth \$2,000. That does not matter; as long as consideration is involved, the contract is binding.

Something that has already been done or something that a person has a legal duty to do is not consideration.

If Mario comes back from his vacation and discovers that two of his employees were responsible for the apprehension of a would-be thief, he may be so happy that he promises to give them each \$100. This is not a legal contract. Consideration is current or future value. Past actions are not part of a legally enforceable contract.

Gloria agrees to purchase a certain percentage of the remote-controlled airplanes she sells from her competitor, the only other company that sells the planes, in exchange for the competitor's promise not to sell planes to consumers at prices below a certain level. This is not consideration on the competitor's part. The agreement would interfere with fair competition. (*Note:* There are exceptions to the consideration requirement.)

Contractual Capacity

All parties to a legally enforceable contract must meet the legal requirements for capacity. Among those who do not meet these requirements are minors (persons under age 21), persons who are under the influence of alcohol or drugs when the agreement is made, and persons who are mentally deficient.

Minors can choose to fulfill the terms of a contract, but since they do not meet the requirements for legal capacity, they are not required to do so. A party who enters into a contract with a minor, however, is obligated to fulfill the terms of the contract. Business owners take great risks if they enter into contracts with minors. A minor may void or enforce the contract. The business owner has no choice—the wishes of the minor must be honored.

If a minor chooses not to honor a contract, the other parties involved may try to recover any goods given to the minor as a part of the contractual agreement, but they cannot legally enforce any other aspects of the contract.

Laura Marcus, a 16-year-old high school junior, is an avid reader. She reads an average of three novels a week. With the price of books increasing steadily, Laura's reading is getting very expensive.

Last month a book club offer came to Laura's house in the mail. Laura could get 10 novels for 99 cents by joining the club. She would then have to purchase 10 novels at their regular prices within 12 months. The offer stated that regular prices would be at least 25 percent less than bookstore prices and that future selections could be made from a list of hundreds of books.

Laura decided it was a great offer. After all, the required 10 novels represented less than one month's purchases. What could go wrong if the purchase requirement was only 10 in one year? Laura signed the form and returned it with the 99 cents. The 10 novels would soon be on their way.

A few days later, Laura's mother noticed the book club brochure and asked Laura about it. Laura explained why accepting the club's offer had been a good decision. Her mother sat down and carefully read the brochure.

After a few minutes she said, "Buying 10 hardcover novels may be very expensive, Laura." Laura had not read the statement that all novels except the first 10 would be in hardcover! Laura intended to pay for the books with earnings from a part-time job. Instead of spending about \$40 as she had calculated, she was obligated to spend much more. Even with a 25 percent discount, the total would be more than \$300.

Sending the signed form to the publisher meant that Laura had entered into a contract. Is there any help for Laura? Is there a way out of this mess?

Laura may either honor the contract and purchase at least 10 more novels, or she may return the 10 paperbacks as soon as she receives them and void the contract.

In another example, a person who is under the influence of alcohol when a contract is negotiated may void the contract, but only if the other party can be restored to pre-contract condition.

Lu-Yin was intoxicated at the time she told Carla she would buy 50 books of the coupons that Carla was selling in her store. Lu-Yin took the coupons and promised to pay Carla \$150 the following week. Later that day, the coupons were stolen from Lu-Yin's car. She sought to void the contract on the grounds that she was intoxicated at the time the contract was made, but since she cannot restore Carla to her pre-contract condition (return the coupons), she must honor the contract and pay the \$150.



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A person who claims mental deficiency as a reason for voiding a contract must prove that the mental deficiency existed at the time the contract was made. The condition does not, however, have to be permanent. Lack of knowledge is not considered mental deficiency.

Jamie is a business owner who can sign his name and read a little, but that's about all. Jamie signed a contract to purchase some expensive equipment from Walt. Afterwards, he explained the deal to his attorney and showed him the contract. After reading it, the attorney told Jamie that, according to the contract, Jamie's cost for the equipment would be about 10 percent higher than the price Walt had quoted verbally.

Jamie sought to void the contract on the grounds that he could not read it and thus did not fully understand what was involved. Jamie must honor



Ethics for ENTREPRENEURS

Jim Tanzi owns an unusual auto body shop in Pueblo, Colorado. He specializes in rebuilding antique automobiles.

When Jim started his business 10 years ago, he had very few customers. However, the last five years have been very busy and very profitable.

Five years ago Jim rebuilt a classic Model A Ford for a customer from Detroit. Shortly after Jim delivered the car, a story featuring the car's owner was printed in a national magazine. The story included a description of the car and mentioned Jim Tanzi. As a result, Jim has been getting business from all over the country. Sometimes he has more than he can handle.

Jim recently agreed to rebuild a 1965 Corvair for a man from Florida. Although he was busy, he thought he could complete the car by the time the man wanted it. They signed an agreement specifying the charges and the delivery date, and Jim scheduled his time so that he could start the Corvair job on June 3.

Jim encountered an unusual problem while working on another project and had to spend a lot of time taking care of it. He knew he was taking more time than he had planned, and there was no way he could get to the Corvair on time. That meant he would not finish it on schedule.

Jim called his cousin Blaine, who was also in the auto body business, and asked him to do the work on the Corvair. Blaine agreed and started immediately. When he finished, Jim checked the work. He was a bit disappointed. Blaine had done a good job, but not as good as Jim might have done. But it would have to do.

When the man from Florida came for his car, Jim told him what he had done and gave him the bill. The man was very angry and refused to pay. He claimed that Jim had breached the contract.

Think Critically

1. Whether or not Jim breached the letter of the contract is something that can only be decided in a court of law. In your opinion, did Jim breach the intent of the contract, which was that he would personally do the work?
2. What would you advise Jim to do?

the terms of the contract, however, because lack of understanding is not the same as lack of legal capacity.

Contractual Form

Contracts can be verbal or written; both are legally enforceable. Some contracts are regulated by the Statute of Frauds and must be written and signed. The **Statute of Frauds** is a collective term describing assorted statutory provisions that render certain types of contracts unenforceable unless they are executed in writing.

Several major examples of contracts that are covered within the Statute of Frauds are the sale of land, the sale of goods exceeding \$500, contracts for services that cannot be performed in one year, and promises to assume the debt or legal responsibility of another. It is always a wise business practice to insist on a written contract anytime a contractual relationship is established.

Do not be fooled into thinking a contract is only a document with “CONTRACT” written at the top of the page. A written contract may be simply a letter addressed to you, as long as it contains all five requirements.

TAXES, LICENSES, AND EMPLOYMENT LAW

Be aware of the personal and business tax implications of starting your own business. Self-employment tax will double, as you must pay both the employer’s and employee’s share of social security and Medicare taxes. Property tax is collected on all personal property owned by a business. Special licenses may be required. City and county government may have special business regulations, sales taxes, personal property taxes, and zoning restrictions that will affect your business.

Make sure you understand your responsibilities as an employer in the following areas: employees vs. independent contractors, leased employees, seasonal employees, personnel policies, finding and hiring employees, employer/payroll registration forms, payroll taxes (filing requirements and forms), workers’ compensation, the Occupational Health and Safety Administration, and the Americans with Disabilities Act.



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Chapter Review

Ship in a BOTTLE

Clearing Customs



Fred was feeling excited as he drove his van to the Atlanta airport to pick up his first inventory shipment of ships in bottles. The \$3,200 shipment had arrived at the Lufthansa Air Cargo Center. When he got there, he was surprised to learn he could not take possession of the goods until they had cleared customs. The woman at the counter sent him to the U.S. Customs Office to arrange clearance.

The process was not as simple as Fred had hoped. The customs agent explained that he could not pick up an overseas shipment worth more than \$2,000 without being bonded. The agent showed Fred an official document stating that importers are required to post a bond “to protect the revenue of the United States or to assure compliance with any pertinent law, regulation or service.” In other words, said the agent, an importer must post a bond to guarantee to U.S. Customs that all import duties, taxes, and charges will be paid and all import laws and regulations be complied with. To post a bond, Fred would have to fill out several forms. Once approved, he could pick up his shipment and all future shipments as well. The agent told Fred it might take a few days to process the paperwork. He suggested that Fred use a customs broker.

A customs broker is a bonded company or agent that handles all paperwork for imported shipments. The broker is notified of incoming shipments and prepares the necessary paperwork to receive clearance. This includes paying all tariffs, taxes, transportation costs, and bond fees. The broker informs the client when a shipment is ready for pickup, and the importer can then go directly to the air cargo center of the delivering airline. The customs broker bills the importer for all charges incurred, plus a fee for its services.

Fred selected JRM International Forwarding Company from a list of customs brokers at the U.S. Customs Office and drove to their nearby office. It quickly became apparent to Fred that using a customs broker was the answer to his dilemma. Since he would initially be bringing in only four to six shipments a year, the cost of the service would be reasonable and would certainly save time. Rose Marie, the manager, was very helpful in explaining the laws covering the intricacies of importing goods. She also made some phone calls and arranged the release of Fred’s shipment later that day.

As it turned out, Fred would not have to pay tariffs on his ships in bottles. Tariffs are taxes imposed on imported goods to protect domestic manufacturers from being severely undermined by low prices in the marketplace. Since there was no ships-in-bottles industry in the U.S., there was no need to impose tariffs.

Fred drove home from the airport with his van full of ships in bottles. It had taken a few extra hours but he had certainly learned a lot about international business.

Think Critically

1. How would you find out the tariff rates imposed on particular products? Select a product line and research the tariffs imposed on importing it.
2. Call or visit the nearest customs broker office and inquire about career opportunities.

Summary

The name of a business should be easy to spell, pronounce, and remember. Do not try to get too fancy. Fancy names can pose problems with spelling and pronunciation for customers. Sometimes the simplest name is the best choice.

Name registration requirements differ from state to state, but there are many similarities. For instance, all companies doing business in Colorado with trade names must register those trade names. Sole proprietorships and general partnerships must register their trade names with the Department of Revenue. According to state law, a trade name is any name other than the full first and last name(s) of the owner(s) of a business entity, including a general partnership.

There are four basic forms of business ownership: sole proprietorship, partnership, corporation, and limited liability company. A sole proprietorship is a business established, owned, controlled, and operated by a single person. The sole proprietorship is the most prominent of the four forms of ownership. In fact, more than 95 percent of all businesses in the United States are sole proprietorships. They are easy to form and allow almost unlimited control of the business.

A partnership is an association of two or more persons to carry on as co-owners of a business for profit. The two major types of partnerships are general and limited. One of the first things that must be done when two or more entrepreneurs are considering a partnership arrangement is to write a partnership agreement. Law in all partnerships does not require written partnership agreements; oral agreements are perfectly legal in some cases. However, a written agreement is strongly recommended. Many future conflicts can be avoided by defining in writing all important aspects of the partnership.

A corporation is a legal entity created by law. One or more people create a corporation. The individuals who start the process of incorporation—creating the corporation—are called promoters. The promoters file articles of incorporation with a state agency, usually the Secretary of State.

Corporations may be domestic or foreign, public or private, or closely held. A popular variation, subchapter S designation must be requested from the IRS by the stockholders. Once requested, it becomes a tax election only. This means it still has all the advantages of a corporation but is taxed differently.

A limited liability company (LLC) is an alternative form of ownership that has been around since the late 1980s. It has become a very popular form of ownership for small business owners. It offers the limited liability protection of a corporation but is taxed like a partnership.

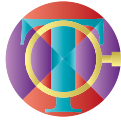
The Federal Trade Commission is a federal administrative agency responsible for ensuring fair, free, and open business. It interprets laws and creates regulations, advises businesses when requested, and investigates when unfair practices are suspected. In the area of advertising, entrepreneurs should be sensitive to false and deceptive advertising, bait and switch advertising, and deceptive pricing. Generally speaking, a warranty is a guarantee of the integrity of a product. Entrepreneurs need to be aware of two types of warranties—express and implied. They are regulated by the FTC through enforcement of the Magnuson-Moss Warranty Act.

Entrepreneurs deal with contracts and agreements—both formal and informal—on a daily basis. Because of the variety and potential complexity of contracts, it is important that entrepreneurs understand the basic principles by which contracts and agreements operate. A contract is a legally enforceable agreement that is negotiated between two or more persons. A contract must fulfill requirements in five areas: agreement, consideration, contractual form, legal capacity, and legality.

Chapter Review

A Case in POINT

Career Decision



Stan Beasley has been working for the past two months on a business plan involving a health club. For most of his life, Stan has been a very successful athlete. In high school he excelled in football and went on to earn a scholarship to a major university. After college he joined a professional team and, for 10 years, was the best defensive safety in the National Football League.

Thanks to his tremendous success in the NFL, Stan is quite wealthy. He doesn't really have to work again, but he thinks he needs to stay busy at something to be happy. Opening a health club seems to be the perfect business, since he has been involved in athletic training for most of his adult life. He feels he possesses the technical know-how to start such a business and keep it running.

Stan has looked at either buying an existing gym or investing in one of several franchise options available. After careful analysis of the pros and cons of each, he has decided to buy an existing gym.

What to call the gym is the next issue. Because he is a football celebrity, he decides that naming the gym after himself would be a wise business move. He finally settles on "The Stan Beasley Health Club." He runs a name check on the Internet to make sure that the name is not already being used and then to register it.

Now Stan is at the point in his business planning where he needs to decide which form of ownership is most appropriate for the new business. He has listed the following points as factors to consider:

1. Capitalization (money) is no problem.
2. He possesses technical expertise.
3. He possesses no business management experience.
4. The current gym owner has agreed to stay and work for Stan for one year.
5. The gym has an established clientele.
6. Health clubs have experienced great financial difficulty in recent years.
7. Lawsuits against health clubs have been increasing.
8. Several friends (ex-football players) have expressed an interest in participating in some way in the venture.

Think Critically

Stan has a difficult decision to make. Give him some help by answering these questions.

1. Should Stan seriously consider a sole proprietorship? Explain your answer.
2. There are at least two ways that Stan could involve his friends as owners of the new business. What are they?
3. If you were Stan, what would be your primary area of concern regarding form of ownership?
4. What form of ownership would you recommend to Stan? Why?

Vocabulary Builder

Write a brief definition of each word or phrase.

- | | | |
|--------------------------------|-------------------------------|-----------------------------|
| 1. bait and switch advertising | 2. consideration | 3. contract |
| 4. corporation | 5. deceptive advertising | 6. express warranty |
| 7. false advertising | 8. Federal Trade Commission | 9. general partner |
| 10. implied warranty | 11. limited liability company | 12. limited partner |
| 13. partnership | 14. partnership agreement | 15. shareholder/stockholder |
| 16. sole proprietorship | 17. Statute of Frauds | 18. stock |
| 19. subchapter S corporation | 20. trade name | |

Review the Concepts

21. What is the legal requirement for naming a business?
22. What are the four basic forms of business ownership?
23. What are the two major types of partnerships? How do they differ?
24. What are the advantages of forming a corporation?
25. What is a limited liability company?
26. What five requirements must a legally enforceable contract fulfill?

Critical Thinking

27. Describe a sole proprietorship, including its advantages and disadvantages.
28. What is false advertising? Deceptive advertising? Give examples of each.
29. Explain the function of the Federal Trade Commission.
30. What are the employer's responsibilities in terms of taxes, licenses, and employment laws?

Project

Build Your Business Plan



1. Choose a name for your business. Justify your choice.
2. Choose two forms of ownership that are possibilities for your business. List the advantages and disadvantages of each form, being specific about your hypothetical business.
3. Choose your form of ownership and list the two most important reasons why you chose it.

Unit 1 CASE STUDY

Writing a Business Plan

Nancy Hickam was feeling nervous as she waited for her appointment with Ms. Ferlano, a vice president with First National Bank and a family friend. Nancy's husband, Tim, had suggested she go to the bank for advice on how to get her business idea off the ground.

Ms. Ferlano greeted her cordially. "Hi, Nancy, it's good to see you. Have a seat. How are Tim and that future president you two are raising?"

"We're fine, Ms. Ferlano. Little Henry is definitely keeping us busy. And so are our jobs. Tim and I feel like we're always on the run. That's why I'm here to see you. I have an idea for a new business, and I need some guidance. I want to open my own antiques shop. I have sales and buying experience from my present job, and I've been buying and learning about antiques for myself as long as I can remember."

"My goodness, Nancy, that's quite a step. Have you considered all the risks involved in owning a business? What information have you collected to support your idea?" Ms. Ferlano asked.

"Actually, I only have a few notes. I've been reading about antiques stores in the antiques magazines I get, and it sounds perfect for me. I estimate it will cost around \$25,000, but I think I can make a good profit. What information do I need?"

"It's a big job, Nancy. You'll need some assistance. You might want to visit with a business consultant. Try the Small Business Development Center at the college, or go downtown to the Small Business Administration and talk to one of their counselors. They'll help you write a business plan. Then come back here, and we'll see if the bank can help you get started financially."

Nancy went home and looked in the yellow pages of the telephone book. She jotted down the phone numbers and addresses of the SBA office and the Small Business Development Center. She also noted a few private business consulting firms. Out of curiosity she called B&B Consulting Services. They invited her to come in and told her that, for a fee, they could write a business plan in a couple of days. It sounded great to Nancy.

Nancy took her notes and her dreams to the consulting firm. They asked her how much money she had available for the new business and how much she hoped to make. True to their promise, they produced a professional-looking, 15-page report a day later that explained how she could open an antiques store with a \$25,000 investment that would produce a \$50,000 profit by the end of the second year of operations. The report provided a general description of the local market and the potential of antique shops. It included some information on setting up a retail store, such as location considerations and expected costs. The fee for the report was \$800. Nancy rushed it to Ms. Ferlano for her opinion.

The banker's reaction shocked her. "Nancy, the bank needs a business plan that specifically addresses your concept and capabilities. This is just a list of statistics about antiques stores. It has very little to do with you or the local market. You need to personalize a business plan to your specific situation. I'm afraid you spent money on information that you could easily have found on the Internet or at the library. I suggest you take your information to

one of the agencies I mentioned before. They'll show you at no charge how to write a business plan for your antiques shop."

The next day Nancy visited Tom Porter at the Small Business Development Center. Tom explained the ingredients of a business plan and directed her to the proper resources for information, including seminars held at the college. "Simplify your approach as much as possible," he said. "Start by writing out a two-paragraph description of your objectives. The first paragraph should address your personal objectives, meaning the personal satisfaction you hope to achieve from this endeavor. The second paragraph should address your financial objectives. State these in terms of the minimum amount of money you must make from the business during the first year to meet your personal obligations. Write down what you anticipate the profits will be after three years and five years. Then list all the things you need to research to complete the business plan. Don't worry too much about the final structure of the plan. I can help you with that later. The main thing is to start writing it out. Putting your idea on paper begins to make it real and helps clarify your thoughts. When you put your objectives in writing and then write a plan to reach those objectives, you've started down the path to owning a successful small business."

That evening, with Tim's help, Nancy wrote the following.

Personal Objective *For the purpose of achieving self-employment, I wish to open a retail antiques shop in Spring County that will primarily sell 19th- and early 20th-century American*

furniture and household items. As a business owner I will be able to control my own destiny and be responsible for all decisions I make concerning the business operation. I will use my previous experience in the management and merchandising of antiques. I will own a business that I will be proud of and receive recognition from my community for my efforts. It will be an enterprise that I can share with family members.

Financial Objective *I am willing to invest \$25,000 of my own resources in this venture if I feel confident that the business will produce a profit of \$20,000 in its first year of operation. I anticipate that the profits will grow to \$40,000 by the end of year three and that I will recapture my initial investment within a five-year period. I am hopeful that the store will open within the next twelve months.*

"Hey, Tim, I'm excited," Nancy exclaimed. "We still have a lot of information to collect and we need to go to some business seminars, but we've taken the first step. Ms. Ferlaino was right. This won't be easy, but anything worthwhile is worth the extra effort."

Case Questions

1. Why isn't it possible for a consulting firm to do a complete business plan?
2. List the elements of a business plan that Nancy will need to address.
3. How does a personal business plan differ from one that is offered to a bank or group of investors to review?