
LESSON THREE

Visual 1

Names of Businesses

Schnurbusch & Assoc., LLC	Daimler Chrysler Corporation
Brandvein & Co. PC	Baco Itaú, S.A.
Cummings Oberkfell & Ristau	Odebrecht of America, Inc.
Adjusters, Inc.	TimAir Limited
Superior Heating and Cooling	Kongsberg Automotive
Rhymes Corporation	B. P. p.l.c.
Beckmann Brothers	Repsol YPF
Chiodini Associates	Ballast Nedam Corporate
Dawdy & Associates, Inc.	Goldman Sachs Group
Kodner Watkins Muchnick & Dunne LLC	Abdul Latif Jameel Group
Bridal Inspirations, Ltd.	Galmiche and Sons Heating and Cooling
Earl Scheib Paint & Body	Toyota Motor Corporation
Miller Plumbing	Boeing Corporation
Mesa Cycles	France Télécom
McDonald's Corporation	AOL Time Warner

Activity 1

The Ant and the Grasshopper's Big Adventure

Part I

When you were a child, you probably read a fable about an ant and a grasshopper. At that time in their lives, Ant was a very responsible saver. She was always putting something away for the future. Grasshopper didn't have the discipline to save. He seemed to spend everything as soon as he got it. Of course, you probably haven't heard much about what happened to Grasshopper and Ant when they grew up.

Ant and Grasshopper both went on to college. Ant earned a degree in accounting with a minor in computer science. She landed a terrific job. Grasshopper earned a business degree. He read about a red hen that opened a baking business. This gave him a great idea for *StarHops*, a coffee shop and bakery. He borrowed from his family and was able to secure a small loan from a local bank to start the business. He opened his shop with little difficulty.

His business was really successful, and he was enjoying himself. He was earning a profit each year and he was free to operate as he chose (as long as he didn't break any laws). He thought he could be even more successful by expanding into neighboring communities. However, he just didn't have the financial capital he needed to buy or rent other locations and equipment, and he couldn't get additional loans from the bank. Liability was a big issue, too. As the owner of the business, he was personally responsible for all obligations, debts, and other liabilities the business incurred. If the business failed, he'd have a lot of problems. He also knew it would be very difficult to manage more than one location. He was already working 60 to 70 hours per week, and was often at his shop from 5:00 a.m. to 6:00 p.m. He really hadn't had a day off for three years!

Grasshopper began to think it might be a good idea to take on a partner. He knew that he could show how successful his shop was, and he thought he could demonstrate how successful another location would be. He even had a partner in mind. He put together a business plan for the expansion and called his old friend Ant.

Ant and Grasshopper met to discuss the possibilities. Grasshopper knew that Ant's computer and accounting skills would really be valuable for the business. Both Ant and Grasshopper agreed that with two of them they could specialize in various tasks, they could share time at the two locations, and they could both earn a living from the business. Both were concerned about problems that might arise. For example, Ant remembered Grasshopper in his younger days, so Ant was very concerned that Grasshopper wouldn't do his share of the work. On the other hand, Ant knew that Grasshopper had been operating a successful business for three years. Grasshopper was concerned about making decisions for the business. He knew that Ant could be pretty pushy sometimes. That might make it difficult to make decisions. On the other hand, Ant had a lot of savings that she was willing to invest to expand the business.

Grasshopper and Ant went to see an attorney, Ms. Centi, to learn more about partnerships. She explained that Ant and Grasshopper would be general partners. This meant that each partner could conduct business on behalf of the partnership and that both could participate in the day-to-day operations of the business. Ant and Grasshopper had some trouble agreeing about

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Activity 1 (continued)

profit sharing. Grasshopper had started the business and wasn't sure he wanted to share profits equally with Ant. Ant wasn't willing to invest her hard-earned savings if she didn't receive a fair share of the profit. Ms. Centi explained that before the contract could be written, Ant and Grasshopper would have to negotiate a decision about whether Ant would be a partner, how much money Ant would put into the business, and what share of the profits Ant would receive if she became a partner.

Part II

After much discussion Grasshopper and Ant decided that Ant would be a partner. She would invest a large portion of her savings into the business. In return, Ant would receive 40% of the business. Ms. Centi explained that this would be included in the contract. Ant and Grasshopper also asked the attorney about liability and taxes, and what would happen if either one of them left the business. Ms. Centi explained that each partner was fully liable for all obligations and debts incurred by the business even when the liabilities were incurred by the actions and decisions of the other partner. She also explained that profits from the partnership would be taxed only once, and that profits or losses from the partnership would be reported on the partners' individual tax returns and taxed at each individual partner's rate. Ms. Centi pointed out that if either Ant or Grasshopper left the partnership or died, the business would have to be reformed and registered with the government, listing all existing partners. She pointed out that the rights and assets given each partner in the contract could not be transferred to anyone else without the consent of the other partner – this would make it harder for Ant or Grasshopper to sell or transfer ownership of the business.

Grasshopper used the information Ms. Centi provided to compare the advantages and disadvantages of sole proprietorship and partnership. Ant reflected on the information Ms. Centi provided in order to decide whether she wanted to become Grasshopper's partner.

Part III

Even though they had some concerns about working together, Ant and Grasshopper both thought it was a good idea. They went back to see Ms. Centi who drew up the partnership contract for them. Grasshopper and Ant were relieved to have everything spelled out carefully.

Wow! What a success the partnership was. Ant worked just as hard as Grasshopper. They were able to share ideas and specialize, too. Ant handled the accounting tasks, inventory, and so forth. Grasshopper handled personnel and customer relations. Often Grasshopper provided entertainment by fiddling familiar tunes at each location one evening a month. Every once in a while each of them was able to enjoy a day off! Occasionally, they had disagreements, but they were able to work things out and the business thrived.

Soon other ants and grasshoppers were interested in being a part of the *StarHops* phenomenon. Ants and grasshoppers in neighboring communities wanted a *StarHops* shop located near them. Grasshopper and Ant were considering expanding the business even more. After all, there were other people interested in the business, but Ant and Grasshopper weren't sure that adding partners was the best thing to do.

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Activity 1 (continued)

Ant decided to investigate some other options for organizing their business. She used her computer skills to search online. She discovered that another option open to them was forming a corporation. She learned that they could form a C-corporation or an S-corporation. First, she decided to focus her research on C-corporations. She found that one major advantage to forming a C-corporation is that liability is limited to the loss of a shareholder's investment. With a C-corporation financial capital of others can be brought to the business through the sale of stock, and stock makes it easy to transfer ownership because stock is easy to transfer or sell from one person to another. Ant also learned that tax payments for her and Grasshopper would change if they formed a corporation. Owners of C-corporations do not report their share of corporate profits on their personal tax returns. The corporation pays corporate taxes on earnings. Owners pay taxes on profits paid out to them in the form of bonuses and dividends. Of course, Ant and Grasshopper would have a lot more forms to fill out, and they would have to pay annual filing fees in the states where they opened *StarHops*. There were also many reporting regulations that had to be met. The idea of forming a C-corporation was sounding more and more complicated.

Ant decided to take a closer look at the S-corporation. She learned that with an S-corporation, liability is also limited to the loss of a shareholder's investment. As with a C-corporation, it is easier for S-corporations to raise capital because stock can be sold to investors, and transfer of ownership is easily done through the sale of stock. She discovered that with an S-corporation, income is reported on shareholders' personal tax returns. The S-corporation itself does not pay any income tax. This eliminates the double taxation that can exist with a C-corporation. Of course there were still fees for incorporating and many reporting regulations. Ant also learned that not every business could qualify as an S-corporation. Only those businesses that are domestic, have only one class of stock, have no more than 75 shareholders, and operate on a calendar tax year can incorporate as S-corporations. Also, all shareholders in an S-corporation must be citizens or residents of the United States.

Ant put together a chart listing the advantages and disadvantages of the S-corporation and the C-corporation and went to meet with Grasshopper.

Activity 2

Grasshopper and Ant Debate

Grasshopper and Ant are considering whether to become partners in the *StarHops* business. If you were Grasshopper, would you make Ant a partner? What share of the profits from the business would you be willing to give Ant?

If you were Ant, would you want to put your savings into Grasshopper's business? What share of the profits would you want?

Consider the following.

- Grasshopper has operated the business successfully for several years and has kept all of the profit earned from the business.
- Grasshopper could hire Ant as an employee and pay Ant a salary higher than what she currently earns.
- Grasshopper could hire Ant at a somewhat lower salary and offer Ant profit sharing. This means that if the business is successful, Ant would receive a bonus or additional payment based on the level of success.
- Grasshopper could make Ant a partner if Ant agrees to buy into the business with some of her savings. But Grasshopper probably wouldn't want to give Ant an equal share in the business. Maybe he would offer her a 30% partnership in the business.
- Ant already has a job and is successful. She may not be willing to leave her rather secure position to work for Grasshopper unless she has a strong incentive to do so.
- Ant will only put her savings into the *StarHops* business if she thinks that the return she will receive is greater than what she currently earns on the financial investments she has.

What type of agreement should Grasshopper and Ant have? *

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Activity 3

Business Organizations: Advantages/Disadvantages

Type of Business Organization	Advantages	Disadvantages
A sole proprietorship is		
A partnership is		
A C-corporation is		
An S-corporation is		