

Legally Speaking

Here's the scenario: You and your team serve as consultants to business owners who need help in deciding which legal form of ownership is best for them. You're currently working with three clients. For each client, you'll evaluate possible legal forms of organization, debate the alternatives, and make a recommendation. Then, you'll write a report to your client, presenting your recommendation and explaining why you arrived at your conclusion.

In addition to learning the basic facts about each company, you've gathered additional information by asking each client the following questions:

- How much control do you want?
- Do you want to share profits with others?
- How much liability exposure are you willing to accept?
- What are your financing needs?
- What are you willing to do to set up and operate your business?
- Should it be possible for the business to continue without you?

The following is the information that you've collected about each client, along with ownership options you should consider.

Client 1: Rainforest Adventures

Rainforest Adventures offers one-day and multiday tours of several locations in Australia. It works both with tourists and with study groups, and its clientele varies from people who want a relaxing experience away from hectic urban life to those who are keenly interested in the exotic environment. The business is dedicated to the preservation of Australia's tropical and wetland preserves. Its guides have many years of experience leading tourists through the rainforests, particularly at night when they come alive.

Rainforest Adventures was started three years ago by Courtney Kennedy, who has fifteen years of experience in the ecotourism industry. She runs the business as a sole proprietorship but is considering a partnership. (She doesn't want the cost or hassle of doing business as a corporation.) In questioning her, you found out the following: Kennedy is dedicated to preserving the Australian wetlands and sees her business as a way of encouraging people to support conservation efforts. However, her guides have displayed an "it's just-a-job" attitude, have become increasingly undependable, and are unwilling to share her commitment. Still, Kennedy has several trusted friends who not only have years of experience as guides, but who also share her enthusiasm for environmental preservation. She's optimistic that they'd be willing to join her in the business. She dreams of expanding her business to offer classes on the ecology of the rainforest but doesn't have enough cash, and she's afraid that a loan application will be turned down by the bank.

Options

Because Kennedy doesn't want to incorporate, she's left with two options: to continue doing business as a sole proprietorship or to find one or more individuals to join her in a partnership. After evaluating these two alternatives, you should recommend the one that you consider most appropriate. You should discuss the pros and cons of both options and explain how each applies to Kennedy's situation. If you recommend forming a partnership, you need to distinguish between a general partnership and a limited partnership, as well as explain what a partnership agreement is, what it covers, and why it's important.

Client 2: Scuffy the Tugboat

Scuffy the Tugboat is a family-run business that makes tugboats. It was formed as a partnership in 1996 by the three McLaughlin brothers—Mick (a naval architect), Jack (an accountant), and Bob (a marine engineer). Their first tugboat is still towing ships in Boston harbor, and over the years, success has allowed them to grow the company by plowing money back into it. Last year's sales were more than \$7 million. Now, however, they want to double production by expanding their factory by five thousand square feet. They estimate a cost of about \$1 million, yet a bigger facility would enable them to avoid late-delivery penalties that can run up to \$2,000 a day. They're not sure, however, about the best way to raise the needed funds. None of the brothers has \$1 million on hand, and because lenders are often hesitant to loan money to shipbuilders, even those with good performance records, local banks haven't been encouraging.

Unlike many partners, the three brothers get along quite well. They're concerned, though, about the risks of taking on personal debts for the business. In particular, they don't like being liable not only for their own actions, but also for the actions of all the partners.

Options

You should recommend that Scuffy the Tugboat either remain a partnership or become a privately-held corporation. State the pros and cons of both forms of organization, and explain how they apply to the brothers' situation.

Client 3: Dinner Rendezvous

For three years, owner Peggy Deardon has been operating Dinner Rendezvous, which gives individuals an opportunity to meet others and expand their social networks, in Austin, Texas. Interested clients go to the company's Web site and fill out applications and privacy statements. There's an annual membership fee of \$125 and a \$15 charge for each dinner attended (plus the cost of dinner and drinks). Deardon sets up all dinners and is onsite at the restaurant to introduce guests and serve complimentary champagne. While the company has a steady clientele, it's not a big moneymaker. If Deardon didn't have a regular full-time job, she couldn't keep the business running. She stays with it because she enjoys it and believes that she provides a good service for Austin residents. Because it's run out of her home, and because her biggest cost is the champagne, it's a low-risk business with no debts. With a full-time job, she also appreciates the fact that it requires only a few hours of her time each week.

Options

Since your client wants advice on whether to incorporate, you should evaluate two options—remaining a sole proprietorship or forming a corporation. In addition to your recommendation, you should state the pros and cons of both forms of organization and explain how they apply to Deardon’s situation.