



**Universität  
Zürich** UZH

Department of Business Administration - Chair for Entrepreneurship

---

# A Primer in Entrepreneurship

Prof. Dr. Ulrich Kaiser

Chair of Entrepreneurship

Universität Zürich

Fall 2011



## Content





**Universität  
Zürich** UZH

Department of Business Administration - Chair for Entrepreneurship

---

# A Primer in Entrepreneurship

Part III Moving from an Idea to an Entrepreneurial Firm

**Lecture 7**

**Preparing a Proper Ethical and Legal Foundation**

Prof. Dr. Ulrich Kaiser  
Chair of Entrepreneurship  
Universität Zürich

Fall 2011



# The Enron Scandal

**BBC NEWS** WORLD EDITION  
Thursday, 22 August, 2002, 16:59 GMT 17:59 UK  
**Enron scandal at-a-glance**  
Click on headings below for details

- Investigators
- Asset sale
- Auditors
- Political links
- UK fallout

**The Enron scandal has far-reaching political and financial implications. BBC News Online reviews the key facts to help you make sense of developments.**

In just 15 years, Enron grew from nowhere to be America's seventh largest company, employing 21,000 staff in more than 40 countries.

But the firm's success turned out to have involved an elaborate scam.

Enron lied about its profits and stands accused of a range of shady dealings, including concealing debts so they didn't show up in the company's accounts.

As the depth of the deception unfolded, investors and creditors retreated, forcing the

<http://news.bbc.co.uk/2/hi/business/1780075.stm>

## The Economist

### Enron and auditing

#### The lessons from Enron

<http://www.economist.com/node/976011>

**After the energy firm's collapse, the entire auditing regime needs radical change**

Feb 7th 2002 | from the print edition

Like 0 Tweet 0

THE mess just keeps spreading. Two months after Enron filed for Chapter 11, the reverberations from the Texas-based energy-trading firm's bankruptcy might have been expected to fade; instead, they are growing. On Capitol Hill, politicians are engaged in an investigative orgy not seen since Whitewater, with the blame pinned variously on the company's managers, its directors, its auditors and its bankers, as well as on the Bush administration; indeed on anybody except the hundreds of congressmen who queued up to take campaign cash from Enron. The only missing ingredient in the scandal—so far—is sex.





# The Murdoch Scandal

## Shareholders sue News Corp. over hacking scandal



Updated | | | Share

NEW YORK (AP) — A group of News Corp. shareholders has sued the media conglomerate over a phone-hacking scandal at its now-closed [News of the World](#) tabloid in London.



Andrew Cowie, AFP/Getty Image

News Corp. chief Rupert Murdoch arrives at his home in Westminster on Monday.

The lawsuit accuses News Corp. (NWS) of large-scale governance failures surrounding the British hacking case. News of the World employees have been accused of hacking into the phone of a missing 13-year-old girl, who was later found murdered, as well as those of other crime victims.

The lawsuit was filed late Friday in Delaware Chancery Court by shareholders led by Amalgamated Bank. Several municipal and union pension funds joined in the lawsuit. The shareholders own less than 1% of News Corp.'s stock combined.



HS11



A Primer in Entrepreneurship, Prof. Dr. Ulrich Kaiser,

COMPANIES & INDUSTRIES July 21, 2011, 12:40 AM EDT

text size: T | T

## Will the Scandal Tame Murdoch?



The News Corp. chief's iron grip could finally be challenged

When Rupert Murdoch faced inquisitors from a British Parliamentary committee on July 19, the public Murdoch was on display: monosyllabic, defiant, and unwilling to accept full responsibility for the corruption that has ensnared his media empire. "A lot of people had different agendas in trying to build this hysteria," Murdoch said when asked who he blamed for the sizeable business setbacks of News Corp. in the U.K., due to the phone hacking scandal. "All our competitors in this country formally announced a consortium to try and stop us. They caught us with dirty hands and built hysteria around it."

It was a characteristic performance from a mogul who's perfected the art of the grand escape during a career in which he has stared down competitors, outmaneuvered rivals, and solidified his command over a media empire built from a single family-owned newspaper.

The question now is whether Murdoch will be able to continue to run his company exactly as he pleases. Government investigators in London and Washington are looking at possible misdeeds involving phone hacking. Shareholders have shaved more than \$5 billion off the company's market value. Even its directors, largely silent in recent weeks except for a few murmurs of support for Murdoch, seem to have taken notice. They've hired Michael B. Mukasey, a former U.S. Attorney General, and Mary Jo White, a former U.S. Attorney in New York, to advise them on governance issues.



## Agenda

### **1. Initial Ethical and Legal Issues Facing a New Firm**

- 1.1 Establishing a Strong Ethical Culture
- 1.2 Choosing an Attorney
- 1.3 Ethically Departing From an Employer
- 1.4 Drafting a Founder's Agreement
- 1.5 Avoiding Litigation

### **2. Choosing a Form of Business Ownership**

- 2.1 Sole Proprietorship
- 2.2 Partnership
- 2.3 Corporation
- 2.4 Limited Liability Company



## Questions



How can ethical and legal errors be avoided ?



What are the advantages and disadvantages of the different forms of legal entity ?

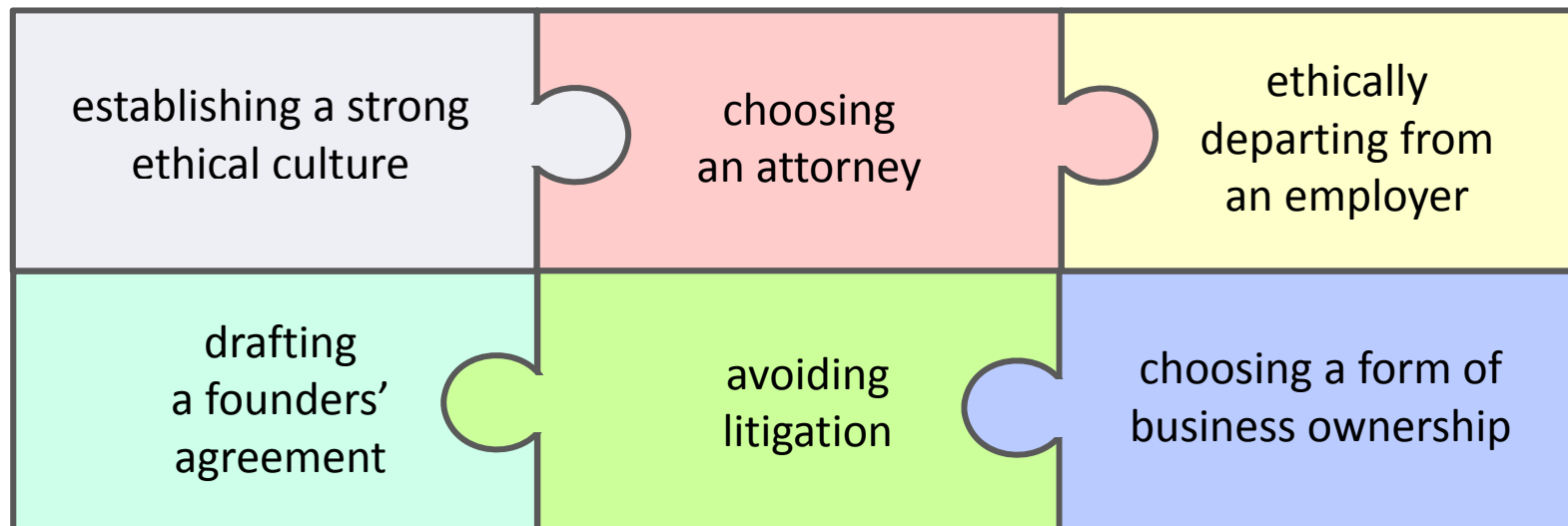
**...to be answered in today's lecture.**



## 1 Initial Ethical and Legal Issues Facing a New Firm

New ventures must deal with important ethical and legal issues at the time of their launching.

Ethical and legal errors made early on can be extremely costly for a new venture down the road.





## 1.1 Establishing a Strong Ethical Culture

Establishing a strong ethical culture may have several potential payoffs.





## 1.1 Establishing a Strong Ethical Culture

### **lead by example**

The most important thing to do in order to build a strong ethical culture is to lead by example.

---

### **establish a code of conduct**

A code of conduct (or code of ethics) is a formal statement of an organization's values on certain ethical or social issues, which provides specific guidance to managers and employees regarding what is expected of them in terms of ethical behavior.

---

### **implement an ethics training program**

Ethics training programs teach and help employees resolve ethical dilemmas in an appropriate manner and improve their overall ethical conduct. An ethical dilemma is a situation that involves doing something that is beneficial to oneself or the organization, but may be unethical.

---



## 1.2 Choosing an Attorney for the New Firm

It is important to select an attorney as early as possible when developing a business venture.

The attorney should be

... familiar with start-up issues;  
... a specialist in dealing with intellectual property issues.

---

An installment plan or other payment arrangements may be needed, since start-ups are usually short on cash.

Several other ways for entrepreneurs to save on legal fees should be considered:

- group together legal matters;
- offer to assist the attorney;
- ask your attorney to join your advisory board;
- use non-lawyer professionals.





## 1.2 Choosing an Attorney for the New Firm

### How to select an attorney...

- Contact the local bar association and ask for a list of attorneys who specialize in start-ups in your area.
- Interview several attorneys.
- Select an attorney who is familiar with the start-up process.
- Select an attorney who can assist you in raising money for your new venture.
- Make sure your attorney has a track record of completing his or her work on time.
- Talk about fees.
- Select an attorney that you think understands your business and that you think you will feel comfortable spending time with.
- Learn as much about the process of starting a business yourself as possible.



## 1.3 Ethically Departing From an Employer

The majority of new ventures is started by people who hold traditional jobs. They should leave their employer following the two most important guidelines.

### Behave in a professional manner

- Give proper notice of an intention to quit
  - Perform all assigned duties until the day of departure and do not spend the last days on making arrangements for the launch of the new venture
- 

### Honor all employment contracts

The *nondisclosure agreement* is a promise made by an employee or another party to not disclose the company's trade secrets.

---

The *noncompete agreement* prevents an individual from competing against a former employer for a specified period of time.

---



## 1.4 Drafting a Founders' (or Shareholders') Agreement

**A founders' (or shareholders') agreement is a written document which deals with issues such as ...**

- the relative split of the equity among the founders;
- how individual founders will be compensated for the cash or the “sweat equity” they put into the firm;
- how long the founders will have to remain with the firm for their shares to fully vest.



## 1.4 Drafting a Founders' (or Shareholders') Agreement

A founders' (or shareholders') agreement includes ...

- Nature of the prospective business
- A brief business plan
- Identity and proposed titles of the founders
- Legal form of business ownership
- Apportionment of stock
- Consideration paid for stock or ownership share of each of the founders
- Identification of any intellectual property signed over to the business
- Description of the initial operating capital
- Buyback clause, which explains how a founder's share will be disposed of if she or he dies, wants to sell, or is forced to sell by court order.



## 1.5 Avoid Litigation

**Most legal disputes are the result of misunderstandings, sloppiness, or a simple lack of knowledge of the law, and should be avoided by entrepreneurs.**

### How to avoid legal disputes

Meet all contractual obligations on time, including paying vendors, contractors, and employees as agreed, and delivering goods or services as promised.

---

Get everything in writing to avoid disputes arising due to a lack of a written agreement or due to poorly prepared written agreements not anticipating potential areas of dispute.

---

Set standards that govern employees' behavior beyond what can be expressed via a code of conduct.

---



## 1.5 Avoid Litigation

If legal disputes occur...

negotiation and mediation may settle disputes rather than more expensive and potentially damaging litigation.

### **81-year-old woman scalded by McDonald's coffee**

In fact, she said, she never would have filed this one if McDonald's hadn't dismissed her request for compensation for pain and medical bills with an offer of \$800.

Only days before the trial, it was ordered that both sides attend a mediation session. The mediator, a retired judge, recommended that McDonald's settle for \$225,000, saying a jury would be likely to award that amount. The company didn't follow his recommendation.

In the end, the jury awarded \$2.9 million to the woman who spilled scalding hot McDonald's coffee on her lap.

Source: <http://www.business.txstate.edu/users/ds26/Business%20Law%202361/Misc/McDonalds%20coffee.pdf>



## 2 Choosing a Form of Business Ownership

When a business is launched, a form of legal entity must be chosen.

Sole Proprietorship

Partnership

Corporation

Limited Liability Company

There is no single form of business ownership that works best in all situations.

It is up to the owners of the firm and their attorney to **select the legal entity** that best meets their needs.

The decision typically hinges on ...

- the cost of setting und maintaining the legal form;
- the extent to which an entrepreneur can shield personal assets from the liabilities of the business;
- tax considerations;
- the ease of raising capital.



## 2.1 Sole Proprietorship

**A sole proprietorship is a form of business organization involving one person:  
The person and the business are essentially the same.**

### primary **advantages**

- creation is easy and inexpensive;
- the owner maintains complete control of the business and retains all the profits;
- business losses can be deducted against the sole proprietor's other source of income;
- no double taxation: since a sole proprietorship is not a separate legal entity, the profits/loss of the business flow through the owner's personal tax return.
- the business is easy to resolve.



## 2.1 Sole Proprietorship

Unlimited liability and difficulty in raising investment capital are the primary reasons entrepreneurs typically prefer other forms of legal entity as opposed to sole proprietorships.

primary **disadvantages**

- liability on the owner's part is unlimited;
- the business relies on the skills and abilities of a single owner to be successful; of course, the owner can hire employees who have additional skills and abilities;
- raising capital can be difficult;
- the business ends at the owner's death or loss of interest in the business;
- the liquidity of the owner's investment is low.



## 2.2 Partnership

Partnerships are organized as either general or limited partnerships.

### *General Partnership*

A form of business organization where two or more people pool their skills, abilities, and resources to run a business.

### *Limited Partnership*

A modified form of a general partnership. The major difference between the two is that a limited partnership includes two classes of owners: general and limited partners.



## 2.2 Partnership

A limited partnership is usually formed to raise money or to spread out the risk of a venture without forming a corporation.

**general partners**  
of a limited partnership

General partners are liable for the debts and obligations of the partnership.

---

**limited partners**  
of a limited partnership

Limited partners are liable only up to the amount of their investment.

---



## 2.2 Partnership

**The primary advantage of a general partnership over a sole proprietorship is that the business is not dependent on a single person for its survival and success**

primary **advantages**

- creating one is relatively easy and inexpensive compared to a corporation or limited liability company;
- the skills and abilities of more than one individual are available to the firm;
- having more than one owner may make it easier to raise funds;
- business losses can be deducted against the partners' other sources of income;
- it is not subject to double taxation.



## 2.2 Partnership

The primary disadvantage of a general partnership is that the individual partners are liable for all the partnership's debts and obligations.

### primary **disadvantages**

- liability on the part of each general partner is unlimited;
- the business relies on the skills and abilities of a fixed number of partners; of course, the owners can hire employees who have additional skills and abilities;
- raising capital can be difficult;
- because decision making among the partners is shared, disagreements can occur;
- the business ends with the death or withdrawal of one partner unless otherwise stated in the partnership agreement;
- the liquidity of each partner's investment is low.



## 2.3 Corporation

**Corporations are separate legal entities organized under the authority of a state as C Corporations (or Subchapter S Corporations).**

A corporation is formed by filing articles of incorporation with the secretary of state's office in the state of the incorporation.

### **C Corporation**

A C Corporation is a separate entity that - in the eyes of the law - is separate from its owners.

---

### **“piercing the corporate veil”**

If the owners of a corporation don't file their annual paperwork, neglect to pay their annual fees, or commit fraud, a court could ignore the fact that a corporation has been established, and the owners could be held personally liable for actions of the corporation.

---



## 2.3 Corporation

### C Corporation

#### primary **advantages**

- owners are liable only for the debts and obligations of the corporation up to the amount of their investment;
- raising money is easy (depending on the strength of the business);
- no restrictions exist on the number of shareholders (which differs from subchapter S corporations);
- stock is liquid if traded on a major stock exchange;
- the ability to share stock with employees through stock options or other incentive plans can be a powerful form of employee motivation.



## 2.3 Corporation

### C Corporation

#### primary **disadvantages**

- setting up and maintaining one is more difficult than for a sole proprietorship or a partnership;
- business losses cannot be deducted against the shareholders' other sources of income;
- income is subject to double taxation: a corporation is taxed on its net income *and*, when the same income is distributed to shareholders in the form of dividends, is taxed again on shareholders' personal income tax returns;
- small shareholders typically have little voice in the management of the firm.



## 2.4 Limited Liability Company

The Limited Liability Company is a form of business organization that is rapidly gaining popularity in the U.S.: It combines the limited liability advantage of the corporation with the tax advantages of the partnership.

primary **advantages**

- members are liable for the debts and obligations of the business only up to the amount of their investment;
- the number of shareholders is unlimited;
- the number of members, tax issues, and implementation is flexible;
- no double taxation, because profits are taxed only at the shareholder level.



## 2.4 Limited Liability Company

The Limited Liability Company is rather complex to set up and maintain, and in some states the rules governing the Limited Liability Company vary.

primary **disadvantages**

- setting up and maintaining one is more difficult and expensive;
- tax accounting can be complicated;
- some of the regulations governing LLCs vary by state.



## Do you know the answer ?



How can ethical and legal errors be avoided ?



What are the advantages and disadvantages of the different forms of legal entity ?

**...test yourself.**

*This website may be useful w.r.t. choosing a form of business ownership:*

*<http://www.kmu.admin.ch/themen/00614/00656/index.html?lang=de>*



## References

Barringer, B. and D., Ireland (2008): Entrepreneurship - Successfully Launching New Ventures, Pearsons Prentice-Hall.



## Outlook

