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Small Business Entry:
Paths to Full-Time
Entrepreneurship

Source: Entrepreneurial Small Business, Katz & Green, 2e
McGraw-Hill/Irwin

Chapter 6

Five Paths to Business Ownership

- You may **start** a new business
- You may **buy** an existing business
- You may **franchise** a business
- You may **inherit** a business
- You may be **hired** to be the professional manager of a small business

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Starting a New Business

- Often, the most risky path promises the greatest rewards.

| Survival Period | Percentage of Businesses Surviving |
|-----------------|------------------------------------|
| 2 years | 66% |
| 4 years | 50% |
| 6 years | 40% |

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- **Advantages of start-ups:** several advantages over buying, franchising, or being an employee
 - Begin with a **clean slate**
 - Use the most up-to-date technologies
 - Provide new, **unique** products or services
 - Can be kept small deliberately to **limit the magnitude** of possible losses

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- **Disadvantages of start-ups:** offset the advantages
 - No initial name recognition
 - Require **significant** time
 - Very **difficult** to finance
 - Cannot easily gain **revolving credit**
 - May not have experienced managers and workers

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Creating a New Business

- **Step One:** Determine what the business is to be
- Starting a **copycat** business provides some protection from failure
- Two-thirds of all start-ups are based on ideas from prior work experience, hobbies, and family-businesses

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Increasing the Chance of Start-up Success

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1. Start the business in a business incubator.
 2. Take part in a mentoring program.
 3. Have a detailed start-up budget.
 4. Produce a product or service for which there is a proven demand.
 5. Secure outside investment.
 6. Start with more than one founder.
 7. Have experience managing small firms.
 8. Have industry experience.
 9. Have previous experience in creating a start-up business.
 10. Choose a business that produces high margins.
 11. Start the business with established customers.
 12. Build trust in your "story".

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Special Strategies for Starting from Scratch

- Home-based businesses: Businesses that are operated from the owner's home
- Partnering: the process of two or more entities agreeing to work together for a common goal
 - Reduce the amount of personal investment in time and money required to make the business succeed
 - "leverage" the contributions of the partner to provide faster growth and higher returns on the investment made in the start-up

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Buying An Existing Business

- Advantages of purchasing an existing business:
 - Established customers
 - Business processes are already in place
 - Often requires less cash outlay

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- Disadvantages of purchasing an existing business:
 - Finding a successful business for sale that is appropriate for you
 - Existing employees may resist change
 - Reputation
 - Facilities and equipment may be obsolete

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- Finding a business to buy:
 - First problem is finding a business for sale
 - Should be in an industry in which you have experience
 - Product or service that has demand and high margins
 - Adequate financing
 - Contact business brokers

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Example

10 Things to Look Out for When Buying a Business

- | | |
|---|--|
| • Ask about sales taxes and payroll taxes | • Get an indemnity from the seller |
| • Find out if you can assume the seller's lease | • Make sure the seller sticks around for a while |
| • Are there prepaid expenses? | • Get to know the employees |
| • Negotiate a "letter of intent" | • Determine who will deal with the accounts receivable |
| • Watch out for bulk sales laws | • Make sure you're buying the assets, not the business |

http://www.entrepreneur.com/startingbusiness/selfassessment/what_to_buy_when_buying_a_business.html

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Performing Due Diligence

- **Due diligence:** process of investigating a business to determine its value
 - Conduct extensive interviews
 - Study financial reports
 - Personal examination of the site
 - Interview customers and suppliers
 - Detailed business plan
 - Negotiate an appropriate price
 - Obtain sufficient capital

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Determining the Value of the Business

- **5 Methods:**
 1. **Discounted cash flows:** cash flows reduced in value because they are to be received in the future
 2. **Book value:** difference between original acquisition cost and the amount of accumulated depreciation

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Determining Value Cont.

3. **Net realizable value:** amount for which an asset will sell, less the costs of selling
4. **Replacement value:** cost to acquire an essentially identical asset
5. **Earnings multiple:** ratio of value of a firm to its annual earnings

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Structuring the Deal

- 4 ways to buy
 - Buy out seller's interest
 - Buy in
 - Buy key assets
 - Takeover

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Franchising A Business

- **Trade name franchising:** agreement that provides to the franchisee only the rights to use the franchisor's trade name and/or trademarks
- **Product distribution franchising:** agreement that provides specific brand name products which are resold by the franchisee in a specific territory

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Franchising A Business

- **Conversion franchising:** agreement that provides an organization through which independent businesses may combine resources
- **Business format franchising:** agreement that provides a complete business format, including trade name, operational procedures, marketing and products or services to sell

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- **Advantages of franchising:**
 - Proven successful business model
 - Receive training and management support
 - Proprietary computer programs
 - Marketing, product placement, advertising, and promotion is all controlled for you
 - Often less risky than starting or acquiring a business

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- **Disadvantages of franchising:**
 - Give up control of marketing and operations
 - Franchisor often sets policies
 - Must buy inventory from specific vendors
 - Regularly inspected
 - Success is determined by success of franchise itself

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Franchise Opportunities

- *Entrepreneur* Magazine
- *Entrepreneur.com* lists over 500 franchises
- Google search of "franchise opportunity" returned 788,000 pages
- International Franchise Association
 - <http://www.franchise.org>
- Australian site
 - <http://www.smallbusiness.gov.au>
- British Government site
 - <http://www.businesslink.gov.uk>

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Example

2007 Fastest-Growing Franchises

- Top Ten
 1. Subway
 2. Jan-Pro Franchising Int'l. Inc.
 3. Dunkin' Donuts
 4. Coverall Cleaning Concepts
 5. Jazzercise Inc.
 6. Jackson Hewitt Tax Service
 7. RE/MAX Int'l. Inc.
 8. CleanNet USA Inc.
 9. Bonus Building Care
 10. Jani-King

<http://www.entrepreneur.com/franchise/fastestgrowing/>

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Inheriting A Business

- Family-owned businesses usually fail after death or retirement of the founder
 - Less than **30%** are successfully transferred after a **second generation**
 - Less than **13%** succeed long enough to be inherited by the **third generation**

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Keys to Success:

- Establish a formal management structure
- Develop a comprehensive business plan
- Hire professional managers to run those functions that family members cannot
- Founder and successor have to work closely together

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Summary

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