

## 6

**Small Business Entry:****Paths to Full-Time Entrepreneurship**

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

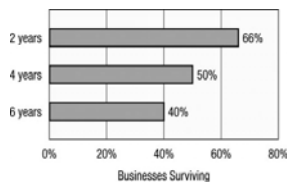
**Chapter 6****Five Paths to Business Ownership**

- 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

6-2

**Chapter 6****Starting a New Business**

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



6-3

**Chapter 6**

- **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

6-4

**Chapter 6**

- **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

6-5

**Chapter 6****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

6-6

## Chapter 6

### Increasing the Chance of Start-up Success

- 
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".

6-7

## Chapter 6

### 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

6-8

## Chapter 6

### Buying An Existing Business

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

6-9

## Chapter 6

- 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

6-10

## Chapter 6

### • 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

6-11

## Chapter 6

### 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/startupbusiness/selfassessment/whyyoudbusinessshouldout/articles/1176.html>

6-12

## Chapter 6

### 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

6-13

## Chapter 6

### 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

6-14

## Chapter 6

### 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

6-15

## Chapter 6

### Structuring the Deal

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

6-16

## Chapter 6

### 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

6-17

## Chapter 6

### 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

6-18

## Chapter 6

- **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

6-19

## Chapter 6

- **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

6-20

## Chapter 6

### 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>

6-21

## Chapter 6

### 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>

6-22

## Chapter 6

### 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**

6-23

## Chapter 6

- **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

6-24

**Chapter 6**

**Summary**

6-25