



B A 250: SMALL BUSINESS MANAGEMENT

Lesson 3: Buying Versus Starting a Small Business/Business Plans

Introduction (1 of 11)

Buying Versus Starting a Small Business/Business Plans

The entrepreneurial spirit can be seen in many different kinds of businesses. As we learned, franchising is one way to enter into the business world. Another option would be to purchase a business that someone else created. Large corporations do this all the time. Google has acquired over 180 companies; since 2010, it acquires about one new company each week ("List of Mergers," 2015, para 1–2).

There are many reasons a large corporation would want to buy an existing business, but, regardless of the reason, someone in the company still needs to be knowledgeable about determining the value of a desired business. Don't you hate it when you pay too much for something? Trust me—shareholders (the true owners of a large corporation) would not be happy if Google paid too much for its purchase of Motorola Mobility (\$12.5 billion) or YouTube (\$1.65 billion) (Hopkins, 2006; Tsukayama, 2011).

You should feel comfortable discussing the basis for valuing a business. You may not become an expert in business valuation and may hire someone to determine business value (much like how we hire a residential real estate appraiser when we are thinking of purchasing a house or condo); even so, you should still have a basic understanding of how valuation works.

In this lesson, you will also want to explore the concept of a business plan. When you interview a small business owner, be sure to ask about his or her business plan. Some owners will say they never created one, and others say the plan guided them to their success. Stories about business plans are as varied as the many different plans in use. There is not one perfect way to create a business plan; however, some basic items should be included. The purpose of this lesson is to introduce you to the basic sections of a business plan.

Learning Objectives

The readings and questions in the lesson should help you to do the following things:

- Identify the benefits and drawbacks of purchasing an existing business.
- Explain the logical flow of buying a business (search, deal transition), as well as the related activities within each stage.
- Compute the value of a business utilizing the adjusted balance sheet valuation technique and the earnings approach.
- Describe the discounted cash flow method for valuing a business.
- Define and recognize the components of a business plan.
- Report on an actual small business's creation and usage of a business plan and interpret whether the use of the plan contributed to the business's success.
- Explain how each section of the business plan can contribute to future success.

Key Terms/Concepts

business plan

an essential road map for business success

business valuation

a financial term used to describe the process of figuring out what an existing business is worth; many models are available, but some of the more common ones include an earnings approach, an asset approach, and a market approach

due diligence

the exercise of reasonable care in the evaluation of a business opportunity

feasibility analysis

a study to determine whether a plan is practical

goodwill

an intangible asset that needs to be considered when buying an existing business; consists of such intangibles as positive customer relations, strong employee relations, brand names, proprietary rights, and a good reputation

lien

the right to take, hold, or sell a debtor's property as security or payment for a debt

net worth

total assets minus total liabilities

Road Map

Readings:	<ul style="list-style-type: none"> • Complete the readings for Lesson 3 listed in the course syllabus. • Read the online commentary for Lesson 3.
Assignments:	<ol style="list-style-type: none"> 1. View the video linked in the Lesson 3 assignments. 2. Complete Quiz 1. 3. Meet virtually with your team and share plans for meeting in Discussion Forum 4 (one member needs to share the team's plans). 4. Request a team Collaborate room (one request per team).

Buying Versus Starting a Small Business: Advantages and Disadvantages

Advantages

Not all entrepreneurs become involved in small business by creating something new and innovative. For many entrepreneurs, the easiest way to quickly become involved in a small business is to purchase an existing business. As in the broader concept of owning a small business, there are many advantages and disadvantages to purchasing a small business. Entrepreneurs must be objective any time they are considering the purchase of a business. Just because the previous owner was able to operate a successful enterprise does not guarantee that the same level of success will continue.

According to Scarborough (2012), advantages may include

- immediate cash flow,
- trained employees,
- established suppliers and credit,
- established customers and referrals,
- existing licenses and permits,
- exclusive rights to sell,
- territory rights,
- one-on-one training by the owner,
- availability of financing,
- a financial track record, and
- proven products and services.

Disadvantages

Conversely, there are many entrepreneurs who feel that they can resurrect any failing business and make it profitable—an illusion that has proven costly. The textbook provides extensive insight into the broad range of factors that should be considered before purchasing any existing business, whether profitable or unprofitable.

According to Scarborough (2012), disadvantages may include

- upfront cash needed;
- inherited employee problems;
- challenges implementing change;
- overvalued accounts receivables;
- outdated equipment, facilities, and inventory;
- a location that may not remain ideal; and
- a potentially overpriced business.



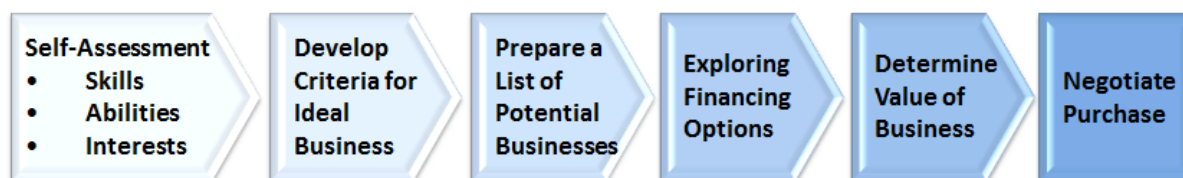
Source: AndreyPopov/iStock/Thinkstock

Steps for Buying a Business

The decision to purchase an existing business should not be made lightly. It involves a serious investment of funds; therefore, you must give careful consideration to the advantages and disadvantages of this option.

Figure 3.1 illustrates the typical steps for purchasing an existing business.

Steps for Purchasing a Business



Graphic created in Microsoft Office (© 2012)

Source: The Pennsylvania State University

Steps for Purchasing a Business

Step 1: Self-Assessment Skills Ability Interests

Step 2: Develop Criteria for Ideal Business

Step 3: Prepare a List of Potential Businesses

Step 4: Explore Financing Options

Step 5: Determine Value of Business

Step 6: Negotiate Purchase

Methods for Valuing a Business

Determining the financial value of a business can become very complex and, often, emotionally charged. As much as individuals with strong financial or accounting backgrounds would like us to believe that valuation is a science, there are many non-financial elements that must be considered, suggesting that the valuation of a business for sale is both science and art.

The valuation of intangible assets, such as goodwill, can add to the complexity of valuing a small business. The value of goodwill, as evaluated from both the buyer's and the seller's perspective, can be worlds apart. The sale of many small businesses has broken down over disagreements about the value of goodwill.

There are a number of techniques available for determining the value of a business's tangible assets. The textbook describes three of them, each having its own advantages and disadvantages:

- the balance sheet method,
- the earnings approach, and
- the market approach.

Relying on multiple methods and making a decision based on a variety of perspectives will likely yield the most accurate result.

The Negotiation Process (7 of 11)



Source: Fuse/Thinkstock

The Negotiation Process

Determining the value of a business from both a seller's and a buyer's perspective provides valuable information that impacts both sides in the negotiation of a sale. However, many other factors on both sides of the deal most certainly come into play in the negotiation process.

Payment terms, the availability of cash, tax issues, the seller's age and health, and future business trends can all have an impact on how the negotiation process unfolds. The textbook also provides insight into how the negotiation process can be influenced and managed.

Existing Businesses (8 of 11)

Existing Businesses

In deciding among sole proprietorships, partnerships, incorporations, or franchising, you must consider many aspects. The following questions must be considered no matter which type of business you're favoring:

- Should you start from scratch with a new business, or should you purchase an existing business?
- What is your personality and skill level?
- Do you want to shape the business from the bottom up and carry the full responsibility for its success or failure, or are you better able to take an existing opportunity and work with it to

develop it into something more?

- What level of resources do you have to draw from?
- What kind of impact can your family handle?

These kinds of decisions require an entrepreneur to be realistic and evaluate his or her pros and cons fairly and objectively. Therefore, it is important to seek advice from experts.

When evaluating an existing business for potential purchase, it is important to understand its financial status and why the current owner is selling. Other important factors include its legal status, assets, liabilities, and potential for growth.

Various alternatives are available for valuing a business. There is no one right approach for determining value. By using different approaches, you can create a deal that is fair for all parties. Conducting research on comparable businesses, traffic flow, the local economy, and business trends is equally important, regardless of whether you are purchasing a franchise business or a locally owned family business. You should make business decisions based on factual information and sound data.

It is important to remember that even with all of this advice, it is just that—advice. When operating your own business, you must always take into consideration all the information, but the ultimate decision rests with you and what you and your partner(s) are willing to do.

The Business Plan (9 of 11)

The Business Plan

Many small businesses do not have a business plan; the entrepreneurs operating these businesses frequently state that they just don't have the time or knowledge to develop one. Effective business plans accomplish more than just providing an operational road map for the guidance of the business. Business plans also provide clear-cut evidence to potential investors that aspiring entrepreneurs have conducted market research, identified potential markets for their products or services, and projected financial outcomes. Business plans are not a guarantee of entrepreneurial success; however, a solidly constructed business plan can contribute to the long-term success of small businesses. The textbook provides a well-constructed template for the creation of a thoughtful and professional business plan and elaborates on the "five Cs" of credit—the criteria many lenders and potential investors use to evaluate an entrepreneur's business concept.



Source: Wavebreak Media/Thinkstock

To be successful and survive, a small business must constantly work at planning. The business plan is one of the most useful and practical tools that result from the planning process. It can be viewed as a road map, blueprint, or guide to help keep the business on track and focused. It is an instrument for introducing others to the business, especially potential financiers. The concept of a business plan and the planning process should be used at multiple levels, not just the strategic level.

A business plan is useful at the operational or tactical level for the introduction of new products and services into the marketplace and for the evolution of existing products and services as the marketplace changes. As a tool, the business plan is very specific to an organization, a product/service, or a product/service group. Even though they are specific, the components of these documents tend to be similar. Every written plan should include some basic elements, such as a cover page, executive summary, and table of contents. The history of the business, as well as its purpose, organizational structure, management skills, and products/services, should also be included.

Video 3.1 (U.S. Small Business Administration, 2013) describes how and why to write a business plan.

Video 3.1. How to Write a Business Plan



Time: 00:02:26

No transcript available.

Should you want to dive deeper into how to create a business plan, the SBA offers an eight part webinar, "[SBA Business Plan Webinar](https://youtu.be/tEL_17klIY8?list=PL47BE70B1D55EC509) (https://youtu.be/tEL_17klIY8?list=PL47BE70B1D55EC509)" which is about 30 minutes in total.

One must remember that planning incorporates multiple assumptions that are constantly changing. The organization must continuously review and update its plans for incorporating assumption changes so that the process itself and the planning tools remain viable and useful. The business must be regularly scanning its environment and reacting accordingly.

References (10 of 11)

References

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Lesson Assignments (11 of 11)

Lesson 3 Assignments

Complete all the following tasks and readings by the due dates listed in the [course syllabus](#).



Quiz 1

Complete [Quiz 1](#) (<https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&MATCH=Quiz+1>), which covers materials from Lessons 1–3. See [Course and Projects Overview](#) in the syllabus for details on the quiz.



Team Project: Meet Your Team

You will work on group projects throughout this course, so it's a good idea to meet your teammates. You have been assigned to a team of your classmates and have a [Private Team Discussion Forum](#) (<https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&MATCH=Private+Team+Discussion+Forum>) should you wish to use it. Other tools you may wish to consider include the following.

Tools Supported by Penn State

- For Collaborate rooms, simply click on the Collaborate link in the main menu. See "Team Collaborate Room Request" below for further instructions.
- [Adobe Connect](https://meeting.psu.edu/) (<https://meeting.psu.edu/>) is another option for connecting and sharing files.
- [Box](http://box.psu.edu/) (<http://box.psu.edu/>) is a way to share and retrieve documents regardless of location.
- [Yammer](http://yammer.psu.edu/) (<http://yammer.psu.edu/>) allows you to collaborate and communicate on team projects.
- [VoiceThread](http://voicethread.psu.edu/) (<http://voicethread.psu.edu/>) may be used to collaborate asynchronously.

Other Tools

- **Google Docs** (<https://docs.google.com/>) is used to connect by sharing and working interactively on your documents regardless of location.
- **Google Hangouts** (<https://plus.google.com/hangouts>) is used to hold video conferences.
- **Slack** (<https://slack.com/>) is a messaging app for teams that includes file sharing (and can be used in conjunction with Google).
- **Skype** (<https://www.skype.com/en/>) is a free means for communicating and holding conference calls.
- **Wikispaces** (<http://www.wikispaces.com/>) is one of the many free wikis on the web that can be set up to allow contributions from many members.
- **Dropbox** (<https://www.dropbox.com/>) is another way to share and retrieve documents regardless of location.

Once your team has decided how you will work together on group projects, one member needs to post your plans in **Discussion Forum 4: Team Plans** (<https://cms.psu.edu/section/content/default.asp?WCI=Goto&WCU=CRSCNT&MATCH=Discussion+Forum+4:+Team+Plans>) so that all teams can see what the others are doing.



Team Collaborate Room Request

In addition to deciding on a tool for interacting, your team will need to decide who is taking the leadership role. That leader needs to request a Collaborate room for the team by clicking on the Collaborate link on the main menu and following the directions on that page. Request a room with manual recordings so that your team can turn recording on when you are ready to record your presentation (and off when you meet or practice). **Only** the team leader needs to request the room. The leader will then receive an e-mail from the HelpDesk indicating that the room has been created. (Save the e-mail!)

This e-mail will contain three links:

- a moderator link that allows full control of the Collaborate room when it is used to log in,
- a link to be shared with team members so that they can gain access to the room, and
- a link for accessing the recorded sessions from the Collaborate room, to be shared with team members so that all can review the materials created.

Your Collaborate room may be used to meet virtually, record your thoughts, or share items. It will be used to record your presentations, so you will want to become comfortable with Collaborate. Please note that **each team member must have a speaking role in the final presentation.**

For additional help on using Collaborate, visit any one of the links below:

- **Blackboard Knowledge Base Information for First-Time Users** (<http://support.blackboardcollaborate.com/ics/support/default.asp?deptID=8336&task=knowledge&questionID=1251>) and
- **Blackboard Users' Guides** (<http://en-us.help.blackboard.com/collaborate/v12>).

Once your team has been granted a Collaborate room, **the team leader needs to forward the HelpDesk e-mail to the instructor.** Be sure to include the names of those on the team.

Please direct questions to the [World Campus HelpDesk](http://student.worldcampus.psu.edu/student-services/helpdesk) (<http://student.worldcampus.psu.edu/student-services/helpdesk>) |

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