CHAPTER 5: BUYING AN EXISTING BUSINESS

CHAPTER OVERVIEW

This chapter highlights the key steps involved in buying an existing business. In particular we will be informed about the techniques for evaluating an existing business, the methods for determining the value of a business, understanding the seller’s side, and negotiating the deal.

By understanding and applying concepts and skills in this chapter we are confident you will tremendously benefit personally and also positively contribute towards your present and future organizations. Learn the skills and apply them and you will be amazed to find how beneficial they are for you and the company you belong to.

CHAPTER LEARNING OBJECTIVES

After studying the chapter and completing the relevant activities and exercises you should be able to:

1. Understand the advantages and disadvantages of buying an existing business.
2. Define the steps involved in the *right* way to buy a business.
3. Explain the process of evaluating an existing business.
4. Describe the various techniques for determining the value of a business.
5. Understand the seller's side of the buyout decision and how to structure the deal.
6. Understand how the negotiation process works and identify the factors that affect the negotiation process.

DISCUSSION QUESTIONS AND SUGGESTED ANSWERS

1. Understand the advantages and disadvantages of buying an existing business.

The *advantages* of buying an existing business include: A successful business may continue to be successful; the business may already have the best location; employees and suppliers are already established; equipment is installed and its productive capacity known; inventory is in place and trade credit established; the owner hits the ground running; the buyer can use the expertise of the previous owner; and, the business may be a bargain.
The *disadvantages* of buying an existing business include: An existing business may be for sale because it is deteriorating; the previous owner may have created ill will; employees inherited with the business may not be suitable; its location may have become unsuitable; equipment and facilities may be obsolete; change and innovation are hard to implement; inventory may be outdated; accounts

receivable may be worth less than face value; and, the business may be overpriced.

2. Define the steps involved in the right way to buy a business.

Buying a business can be a treacherous experience unless the buyer is well prepared. The right way to buy a business is: analyze your skills, abilities, and interests to determine the ideal business for you; prepare a list of potential candidates, including those that might be in the "hidden market"; investigate and evaluate candidate businesses and evaluate the best one; explore financing options before you actually need the money; and, finally, ensure a smooth transition.

3. Explain the process of evaluating an existing business.

Rushing into a deal can be the biggest mistake a business buyer can make. Before closing a deal, every business buyer should investigate five critical areas:

1. Why does the owner wish to sell? Look for the *real* reason.
2. Determine the physical condition of the business. Consider both the building and its location.
3. Conduct a thorough analysis of the market for your products or services. Who are the present and potential customers? Conduct an equally thorough analysis of competitors, both direct and indirect. How do they operate and why do customers prefer them?
4. Consider all of the legal aspects which might constrain the expansion and growth of the business - Did you comply with the provisions of a bulk transfer? Negotiate a restrictive covenant? Consider ongoing legal liabilities?
5. Analyze the financial condition of the business, looking at financial statements, income tax returns, and especially cash flow.

4. Describe the various techniques for determining the value of a business.

Placing a value on a business is partly an art and partly a science. There is no single "best" method for determining the value of a business. The following techniques (with several variations) are useful: the balance sheet technique (adjusted balance sheet technique); the earnings approach (excess earnings method, capitalized earnings approach, and discounted future savings approach); and the market approach.

5. Understand the seller's side of the buyout decision and how to structure the deal.

Selling a business takes time, patience, and preparation to locate a suitable buyer, strike a deal, ad make the transition. Sellers must always structure the deal with tax consequences in mind. Common exit strategies include: a straight business sale, forming a family limited partnership, selling a controlling interest in the business, restructuring the company, selling to an international buyer, using a two-step sale, and establishing an employee stock ownership plan (ESOP).

6. Understand how the negotiation process works and identify the factors that affect the negotiation process.

The first rule of negotiating is never confuses price with value. In a business sale, the party who is the better negotiator usually comes out on top. Before beginning negotiations, a buyer should identify the factors that are affecting the negotiations and then develop a negotiating strategy. The best deals are the result of a cooperative relationship between the parties based on trust.

CHAPTER 6: BUILDING A POWERFUL MARKETING PLAN

CHAPTER OVERVIEW

This chapter signifies the importance of a powerful marketing plan and its importance for the success of a business. Other topics include Guerrilla marketing plan, determining customer needs and wants, pinpointing the target market, plotting a marketing strategy, and marketing on the world wide-web.

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CHAPTER LEARNING OBJECTIVES

After studying the chapter and completing the relevant activities and exercises you should be able to:

1. Describe the principles of building a guerrilla marketing plan and explain the benefits of preparing one.
2. Discuss the role of market research in building a guerrilla marketing plan and outline the market research process.
3. Explain how small businesses can pinpoint their target markets.
4. Describe the factors on which a small business can build a competitive edge in the marketplace: customer focus, quality, convenience, innovation, service, and speed.
5. Discuss the marketing opportunities the World Wide Web (WWW) offers entrepreneurs and how to best take advantage of them.
6. Discuss the "four Ps" of marketing – product, place, price, and promotion – and their role in building a successful marketing strategy.

DISCUSSION QUESTIONS AND SUGGESTED ANSWERS

1. Describe the principles of building a guerrilla marketing plan and explain the benefits of preparing one.

A major part of the entrepreneur's business plan is the marketing plan, which focuses on a company's target customers and how best to satisfy their needs and wants. A solid marketing plan should: determine customer needs and wants through market research; pinpoint the specific target markets the company will serve; analyze the firm's competitive advantages and build a marketing strategy around them; create a marketing mix that meets customer needs and wants.

2. **Discuss the role of market research and outline the market research process.**

   Market research is the vehicle for gathering the information that serves as the foundation of the marketing plan. Good research does *not* have to be complex and expensive to be useful. The steps in conducting market research include: defining the problem – "What do you want to know?"; collecting the data from either primary or secondary sources; analyzing and interpreting the data; drawing conclusions and acting on them.

3. **Explain how small businesses can pinpoint their target markets.**

   Sound market research helps the owner pinpoint his target market. The most successful businesses have well-defined portraits of the customers they are seeking to attract.

4. **Describe the factors on which a small business can build a competitive edge in the marketplace: customer focus, quality, convenience, innovation, service, and speed.**

   When plotting a marketing strategy, owners must strive to achieve a competitive advantage - some way to make their companies different from and better than the competition. Successful small businesses rely on six sources to develop a competitive edge: a focus on the customer; devotion to quality; attention to convenience; concentration on innovation; dedication to service; and, emphasis on speed.

5. **Discuss the marketing opportunities the World Wide Web (WWW) offers entrepreneurs and how to best take advantage of them.**

   The Web offers small business owners tremendous marketing potential on par with their larger rivals. Entrepreneurs are just beginning to uncover the Web's profit potential, which is growing rapidly. Establishing a presence on the Web is important for companies targeting educated, wealthy, young customers. Successful Websites are attractive, inviting, easy to navigate, interactive, and offer users something of value.

6. Discuss the "four Ps" of marketing - product, place, price, and promotion - and their role in building a successful marketing strategy.

The marketing mix consists of the "4 Ps": **Product.** Entrepreneurs should understand where in the product life cycle their products are. **Place.** The focus here is on choosing the appropriate channel of distribution and using it most efficiently. **Price.** Setting the right price for a product or service is partly an art and partly a science. **Promotion.** Promotion involves both advertising and personal selling.

CHAPTER 7: ADVERTISING AND PRICING FOR PROFIT

CHAPTER OVERVIEW

This chapter emphasizes the key role of promotion through advertising and pricing for profit two key functions of a good marketing effort. Defining the concepts of promotion, advertising plan, advertising budget the section focuses on how to advertise big on a small budget. Additionally we will also learn about the good pricing skills consisting of a creative blend of art and science..

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CHAPTER LEARNING OBJECTIVES

After studying the chapter and completing the relevant activities and exercises you should be able to:

1. Explain the differences among promotion, publicity, personal selling, and advertising.
2. Describe the advantages and disadvantages of the various advertising media.
3. Identify four basic methods for preparing an advertising budget.
4. Explain practical methods for stretching a small business owner's advertising budget.
5. Describe effective pricing techniques for introducing new goods or services and for existing ones.
6. Explain the pricing methods and strategies for retailers, manufacturers, and service firms.
7. Describe the impact of credit on pricing.

DISCUSSION QUESTIONS AND SUGGESTED ANSWERS

1. **Explain the differences among promotion, publicity, personal selling, and advertising.**
   Promotion is any form of persuasive communication designed to inform consumers about a product or service and to influence them to purchase these goods or services.

Publicity is any commercial news covered by the media that boosts sales but for which the small business does not pay.
Personal selling is the personal contact between sales people and potential customers resulting from sales efforts.
Advertising is any sales presentation that is nonpersonal in nature and is paid for by an identified sponsor.

2. Present the steps in developing an advertising plan.

The first step is to define the purpose of the company's advertising program by creating specific, measurable objectives.
The next step is to analyze the firm and its target audience.
The next step involves deciding what to say and how to say it, making sure to build the message around the company's unique selling proposition (USP).
The final step involves evaluating the ad campaign's effectiveness.

3. Describe the advantages and disadvantages of the various advertising media.

The medium used to transmit an advertising message influences the consumer's perception - and reception - of it.
Media options include: newspapers, radio, television, magazines, direct mail, the World Wide Web, outdoor advertising, transit advertising, directories, trade shows, special events and promotions and point-of-purchase ads.

4. Identify four basic methods for preparing an advertising budget.

Establishing an advertising budget presents a real challenge to the small business owner.
Here are four basic methods: what is affordable; matching competitors; percentage of sales; objective-and-task.

5. Explain practical methods for stretching the small business owner's advertising budget.

Despite their limited advertising budgets, small businesses do not have to take a second-class approach to advertising. Three techniques that can stretch a small company advertising dollars are cooperative advertising, shared advertising, and publicity.

6. **Describe effective pricing techniques for introducing new goods or services and for existing ones.**

   Pricing a new product is often difficult for the small business manager, but it should accomplish three objectives: getting the product accepted; maintaining market share as the competition grows; and earning a profit. Generally, there are three major pricing strategies used to introduce new products into the market: penetration, skimming, and sliding-down-the-demand-curve.
   Pricing techniques for existing products and services include odd pricing, price lining, leader pricing, geographical pricing, opportunistic pricing, discounts, and suggested retail pricing.

7. **Explain the pricing methods and strategies for retailers, manufacturers, and service firms.**

   Pricing for the retailer means pricing to move merchandise. Markup is the difference between the cost of a product or service and its selling price. Most retailers compute their markup as a percentage of retail price, but some retailers put a standard markup on all their merchandise; more frequently, they use a flexible markup.
   A manufacturer's pricing decision depends on the support of accurate cost accounting records. The most common technique is cost-plus pricing, in which the manufacturer charges a price that covers the cost of producing a product plus a reasonable profit. Every manufacturer should calculate a product's break-even price, the price which produces neither a profit nor a loss.
   Service firms often suffer from the effects of vague, unfounded pricing procedures, and frequently charge the going rate without any idea of their costs. A service firm must set a price based on the cost of materials used, labor involved, overhead, and a profit. The proper price reflects the total cost of providing a unit of service.

8. **Describe the impact of credit on pricing.**

   Offering consumer credit enhances a small company's reputation and increases the probability, speed, and magnitude of customers' purchases. Small firms offer three types of consumer credit: credit cards, installment credit, and trade credit (charge accounts).

CHAPTER 8: MANAGING CASHFLOW

CHAPTER OVERVIEW

This chapter focuses on Cash Management one of the key managerial areas highly critical for small businesses. The section clarifies that cash and profits are not the same and discusses cash budget, the big three of cash management and avoiding cash crunch.
By understanding and applying concepts and skills in this chapter we are confident you will tremendously benefit personally and also positively contribute towards your present and future organizations. Learn the skills and apply them and you will be amazed to find how beneficial they are for you and the company you belong to.

CHAPTER LEARNING OBJECTIVES

After studying the chapter and completing the relevant activities and exercises you should be able to:

1. Explain the importance of cash management to a small business's success.
2. Differentiate between cash and profits.
3. Understand the five steps in creating a cash budget and use them to create a cash budget.
4. Describe fundamental principles involved in managing the "Big Three" of cash management: accounts receivable, accounts payable, and inventory.
5. Explain the techniques for avoiding a cash crunch in a small company.

DISCUSSION QUESTIONS AND SUGGESTED ANSWERS

1. **Explain the importance of cash management to a small business's success.**
   Cash is the most important but least productive asset the small business has. The manager must maintain enough cash to meet the firm's normal requirements (plus a reserve for emergencies) without retaining excessively large, unproductive cash balances. Without adequate cash, a small business will fail.

2. **Differentiate between cash and profits.**

   Cash and profits are *not* the same. More businesses fail for lack of cash than for lack of profits.
   Profits, the difference between total revenue and total expenses, are an accounting concept. Cash flow represents the flow of actual cash (the only thing businesses

can use to pay bills) through a business in a continuous cycle. A business can be earning a profit and be forced out of business because it runs out of cash.

3. Understand the five steps in creating a cash budget and use them to create a cash budget.

The cash budgeting procedure outlined in this chapter tracks the flow of cash through the business and enables the owner to project cash surpluses and cash deficits at specific intervals. The five steps in creating a cash budget are as follows: forecasting sales, forecasting cash receipts, forecasting cash disbursements, and determining the end-of-month cash balance.

4. Describe fundamental principles involved in managing the "Big Three" of cash management: accounts receivable, accounts payable, and inventory.

Controlling accounts receivable requires business owners to establish clear, firm credit and collection policies and to screen customers *before* granting them credit. Sending invoices promptly and acting on past-due accounts quickly also improve cash flow. The goal is to collect cash from receivables as quickly as possible.
When managing accounts payable, a manager's goal is to stretch out payables as long a possible without damaging the company's credit rating. Other techniques include: verifying invoices before paying them, taking advantage of cash discounts, and negotiating the best possible credit terms.
Inventory frequently causes cash headaches for small business managers. Excess inventory earns a zero rate of return and ties up a company's cash unnecessarily. Owners must watch for stale merchandise.

5. Explain the techniques for avoiding a cash crunch in a small company.

Trimming overhead costs by bartering, leasing assets, avoiding nonessential outlays, using zero-based budgeting, and implementing an internal control system boost a firm's cash flow position.
Also, investing surplus cash maximizes the firm's earning power. The primary criteria for investing surplus cash are security and liquidity.