Chapter 3

FINDING OPPORTUNITY IN AN EXISTING BUSINESS

Learning Objectives

1. Understand the potential benefits of buying a going concern.
2. Identify potential drawbacks of purchasing a business.
3. Learn how to identify and evaluate purchasing opportunities.
4. Learn how to determine the value of a business.
5. Learn how to negotiate and close the deal.
6. Recognize joining a family business as an entrepreneurial pathway.


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"I have found no greater satisfaction than achieving success through honest dealing and strict adherence to the view that, for you to gain, those you deal with should gain as well."

—Alan Greenspan, Former Chairman of the Federal Reserve Bank

Many businesses succeed through the entrepreneurial effort of owners who were not the founders. Charles R. Walgreen, Sr., became a store owner in 1901 when he purchased a pharmacy from Isaac Blood in Chicago for $6,000.[1] Walgreen had worked at the store as a pharmacist and was not satisfied with the quality or customer service there or at pharmacies in general. (He had worked in drugstores since he was a teenager.) However, he saw value in taking over a business that was already in existence, and started with one that he knew well. Walgreen saw that the neighborhood was thriving, but the store was struggling. It did not take long for Walgreen's innovative approach to store layout and merchandising to reap rewards. He opened a second store in 1909 and by 1919, he had incorporated 20 stores as Walgreen's Inc.

Not content to rest on this success, Walgreen's "shook up" the soda fountain portion of the pharmacy business in 1922 with the invention of the malted milkshake by Ivar "Pop" Coulson, which was a revolutionary product and boosted sales phenomenally. By 1926, Walgreen had opened his 100th store in Chicago, and the company went public the following year. In 1939, upon its founder's death, Walgreen's transitioned the presidency to his son, Charles Walgreen, Jr., illustrating business growth through acquisition, a public stock offering, and generational transfer. This leadership change was followed by continued expansion that resulted in Walgreen's becoming the nation's largest self-service retailer by 1953.

Walgreen's continued to grow and successfully transferred the presidency to the third generation in 1969. The company reached the $1 billion sales mark in 1975 and opened its 1,000th store in 1984. Charles Walgreen III retired in 1999 but remained on the board of directors. Walgreen's continued its rapid growth trajectory through acquisition, including the acquisition of New York's Duane Read chain and Take Care Health Systems, adding clinics to its business mix.

Walgreen's is a classic example of entrepreneurial success through acquisition and internal growth.

Many entrepreneurs, like Charles Walgreen, Sr., elect to purchase a going concern rather than starting a business "from scratch." Others decide to apply their entrepreneurial talents to existing family-owned businesses they buy.

Lightworks Media/Alamy

[1] *Source: Walgreen's.* Accessed March 17, 2009 and July 3, 2013, http://www.walgreens.com/marketing/about/history.

Exhibit 3-1 *Entrances and Exits of U.S. Establishments, 2007–2011*

	2007	2008	2009	2010	2011
Entrants	819,375	712,836	609,303	662,975	682,171
Exits	713,588	704,795	805,677	705,659	659,452
Net Job Creation	1,368,177	863,022	−5,931,824	−1,715,301	1,777,680

Source: U.S. Dept of Commerce, Bureau of the Census, "Business Dynamics Statistics," accessed July 3, 2013, http://www.census.gov/ces/dataproducts/bds/data_firm.html.

Both approaches are potential pathways to success through opportunities found in already existing businesses. Approximately 750,000 businesses change ownership each year, demonstrating the popularity of this option. **Exhibit 3-1** provides insights into the number of business starts and closures per year, which illustrates that the number of businesses changing ownership is greater than the number started de novo.

Reasons to Buy an Existing Business

Learning Objective 1

Understand the potential benefits of buying a going concern.

Becoming a successful entrepreneur is a process that can be simplified and accelerated by purchasing an operating business. Entrepreneurial risk can be reduced and potential bargains may be available. However, buying an existing business can also be a route to ownership that is fraught with pitfalls. This is truly a case of *caveat emptor*—let the buyer beware. However, the well-prepared shopper can find the right business to buy.

Quicker, Easier Start-Up

A successful existing business has already leapt over many of the hurdles that would be encountered by a start-up venture. The issues of location, customer development, product or service delivery, and supplier relationships, among others, have been addressed. By acquiring existing relationships and operations, you can save much of the time and effort required to put these into place. Employees can be a particularly valuable part of an acquisition, as they bring institutional memory and relationships to the new owner. In many cases, the seller will also agree to remain in the business for a predetermined length of time to assist in the transition.

Of course, the full benefits of these assets will be realized only if they are truly represented. For example, employees will have to stay with the firm and cooperate with the new owner to provide the value expected. Customer, supplier, and financial-institution relationships need to be positive and healthy. If these conditions are met, you may be many steps ahead of the game by purchasing the right business.

Reduced Risk

Entrepreneurs who carefully consider the best fit for themselves and perform a thorough search and careful research can significantly decrease the risk of failure through an acquisition. The majority of small businesses that change owners are still in business five years later, about double the rate of start-up survival.

Stepping into an existing business can reduce risks associated with uncertainties and unknowns. Start-up businesses face multiple risks, primarily those of not finding a sufficient market and not being able to operate profitably. By buying a going concern, you can take advantage of the established customer base and the systems that are in place to generate cash flows and profits. Whereas past success does not ensure future success, it does increase the likelihood that a business will be profitable.

Bargain Potential

Whereas bargain hunting is not likely to be your primary motivation in purchasing an existing business, it is possible to buy a going concern for less than it would cost to start a similar company. In some cases, a business may be losing money according to its books and records but reveal a solid cash-flow opportunity when examined closely. Or, there may be waste and poor management that can be improved upon to gain value. By the same token, an overly eager seller or a price that sounds too good to be true may be a sign that the opportunity actually *is* too good to be true. This is another example of why solid research and due diligence is so critical to a purchasing decision.

Your Knowledge Can Be Beneficial

If you find a business for sale that you already understand, it can jump-start the ownership process. It may be that you work in the same industry or type of firm. Or perhaps this type of company is a supplier to or a customer of your current company. Maybe you have transferable skills from prior experience that fit.

You can have an understanding of a business from skills attained in your volunteer activities, or as a stay-at-home parent or caregiver, rather than through employment experience. Or, you can seek out employment in the type of company you want to purchase so that you will have operating experience in advance. For example, buying a restaurant without ever having managed one is often a recipe for disaster.

Of course, if you have an opportunity to buy the business where you work, you may have an advantage. In this case, you may already know the positive and negative aspects of the business and can make a more informed decision. Be careful, though, because your perspective as an employee may be limited or biased.

In any event, if you have or can build an understanding of the type of business you are buying, you will make a more informed purchase decision and reduce your learning curve.

Potential Pitfalls of Buying an Existing Business

Learning Objective 2
Identify potential drawbacks of purchasing a business.

Whereas an existing business can provide a hedge against entrepreneurial risk, there are numerous hazards in purchasing a going concern. Typically, you will have to secure more capital to buy a business than to start one up because you are paying for the established customer base, supplier relationships, and skilled employees. Another pitfall that can be fatal is the potential for being misled, whether intentionally or not, regarding the true condition and viability of the firm. Yet another is electing to take ownership of a company built in the mold of the previous owner and finding that it is not a good fit for you. Still another frequent issue is that a company's existing customers often are no longer customers after the sale. The customers of a company before it is sold do not necessarily remain so afterwards, in which case revenues will be lower than anticipated. These dangers can be avoided, or at least minimized, by carefully researching every aspect of the organization, its customers, suppliers, and employees, as well as the financial

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Global Impact . . .

Buying Ownership in a Business You Understand—Globally and Locally

Theresa Rogers has had a lifelong passion for wine. She has taken that passion, and her extensive knowledge of the industry, and applied it to running Horseneck Wines and Liquors since she purchased the company in 1989. Rogers began studying Hugh Johnson's *Pocket Encyclopedia of Wine* at the age of 19 and secured a job as a salesperson in the Fine Wine division of Heublein, covering the five boroughs of New York; from working on commission, she rose to managing a sales force. From there, Rogers worked with a small company to build a brand called Bollini Chardonnay, the first Italian Chardonnay to be marketed across the United States that sold for less than $10 per bottle. Rogers built the brand to 30,000 cases in the major American markets over a three-year period. She then went to work for the Empson Company, one of the first Italian exporters of the finest Italian wines, such as Gaja from the Piedmont region. Rogers works with Angelo Gaja to bring his brand to the forefront of the Barbarescos and Barolos.

Rogers bought her first store in 1986 and sold it in 2005. She purchased Horseneck, located in Greenwich, Connecticut, as her second store. Horseneck Wines and Liquors has grown from a $500,000 wine shop into a firm with $5 million in annual sales and one of the largest collections of fine and rare wines in the state. Rogers took an existing business and built on its potential by plowing her profits back into the company and creating market opportunities. She established her networks and customer base through contributions to charity events, holding wine-tasting parties, and building relationships with local retailers and restaurateurs. As with any wine store, Horseneck sells a range of international wines and spirits, but went one step further—collecting rare wines and carrying the largest collection of Bordeaux, Burgundies, and Italian wines in Connecticut. Rogers started with an existing business and made it truly her own.

Source: Courtesy of Horseneck Wine and Liquors.

reports and tax returns. Outside counsel regarding the accounting and legal issues involved is strongly recommended. Again, due diligence and thoughtful deliberation are essential ingredients to a business purchase.

Investment Requirements

Buying an existing business will require gathering the financial resources needed to complete the transaction and operate successfully. When you start a business from scratch, you will have to build your own customer base, create your brand, hire employees, and develop a supply chain. When you buy a business, this work has been done for you, but the individual who did all that—the owner—will need to be compensated for it, raising the financing requirements.

Buying Someone Else's Problems

Whereas buying a business has many advantages that may translate into market benefits, you will also take over its challenges and problems. Some of these challenges may be obvious and are among the reasons that you saw value in buying the business in the first place. Others may be well hidden and need digging to discover. Undisclosed issues might include:

- dissatisfied customers, suppliers, employees, or creditors;
- plant and equipment that is obsolete, inefficient, or in need of costly repairs;
- lack of innovation or failure to keep up with market trends;
- obsolete or overvalued inventory and/or accounts receivable; and
- patents no longer valid and in force (this can be discovered through the U.S. Patent and Trademark Office).

These types of issues can catch you off guard, cost you your investment, and bring a lot of heartache. Be deliberately diligent in understanding exactly what you are getting and not getting.

Business Is Not a Good Fit

Whereas it is important to find a business that meets the prospective buyer's financial, industry, and other criteria, none of those factors will matter if it does not fit well with personality, lifestyle, and work-environment requirements. It is easy to get caught up in the excitement of the purchase, but a business that is a poor fit at the owner level will soon become a burden, no matter how outwardly successful it may be or become. You need to "keep your eyes on the prize" and remember that the prize includes lifestyle factors that are important to you.

Examples of poor fits abound. For example, if you are hands off as a manager and you buy a business that requires you to get out on to a production floor and roll up your sleeves whenever someone is out, or you have to be "chief cook and bottle washer," you may rapidly come to resent the business. If you like to work late at night but need to be present during traditional retail store hours, you will be exhausted and unhappy, at least until you can afford to comfortably adapt your schedule.

Finding and Evaluating Available Businesses

The process of finding and evaluating available businesses is similar to that of identifying a business to start or franchise to buy. The first step is to carefully evaluate your personal goals and objectives and the support of those closest to you. Through an iterative process, you can determine your focus and gather data accordingly. Once you have identified one or a few prospective sellers, the critical stage will be due diligence followed by negotiation and closing the deal.

Learning Objective 3
Learn how to identify and evaluate purchasing opportunities.

Sources of Existing Businesses

Sources of leads to available businesses abound. The challenge is identifying the sources most suited to your individual goals and objectives and sifting through the potentially overwhelming amount of data to find the pertinent information for decision making. At first, your search may be extremely broad, much as it could be for a franchise opportunity. After thoughtful evaluation of your decision-making criteria and priorities, it should be possible to narrow the search to businesses meeting your industry, geography, size, life-cycle, profitability, and other criteria. **Exhibit 3-2** lists a number of sources for leads regarding businesses for sale.

In addition to the do-it-yourself sources noted in the exhibit, **business brokers** buy and sell businesses for a fee, in essence serving as a matchmaker. These brokers may have a small portfolio of businesses they are selling, or they may be part of a regional, national, or international network of brokers. Their income is based on their ability to close a sale, so be wary of any broker who seems overly aggressive. The International Business Brokers Association, Inc., is the largest association in the industry, so check to see if a broker is a member. You may also want to check with your local Better Business Bureau and with the broker's references before paying any fees or entering into an agreement. As with any contractual relationship, proceed with due caution and understand what you realistically can gain through the process.

business broker a company or individual that buys and sells businesses for a fee.

Exhibit 3-2 *Sources of Leads on Businesses for Sale*

Type/Source	Resource/Opportunity
Direct Inquiry/Networking	
Current employer	Opportunity to purchase the business or referral to available businesses
Current commercial customers and suppliers	Opportunity to purchase the business or referral to available businesses
Competitors	Opportunity to purchase the business or referral to available businesses
Friends and family	Networks with leads to businesses for sale
Solicitation	
Direct mail	Using a limited mailing to targeted companies and/or individuals seeking leads
Advertising—local and regional publications, business magazines and newspapers, trade publications. (See *SRDS Business Publications* for a list of trade journals.)	Advertisements of businesses for sale and/or placing an advertisement for a purchase. Trade publications can be particularly useful when searching for a particular type of company.
Internet	
BizBuySell—http://www.bizbuysell.com	Sends registered users e-mail alerts regarding businesses for sale
Craigslist—http://www.craigslist.org	Free listing service for sellers and buyers
Business Broker Net—http://www.businessbroker.net	Classified advertising for buyers and sellers
BizQuest—http://www.bizquest.com	Searchable paid listings of businesses for sale
Merger Network—http://www.mergernetwork.com	Matching qualified-buyer members with sellers

However you identify a business to buy, it is crucial to have others on your team (or at least, on your side) who know what they are doing with respect to the business you are considering. It is even better if they have done this before. Having access to resource people that have also started and operated a business can help.

Due Diligence—Reality versus the Story

The process of searching for and identifying a business to buy can be an exhilarating and emotional time. It is also a time when rational thought and clear, well-developed research and analysis will be critical to success. It is easy to fall in love with the idea of owning a business and overlook the

Step into the Shoes . . .

ThompsonGas—Acquiring Opportunities

J. Randall (Randy) Thompson grew up with ThompsonGas as a presence in his life. His grandparents, Lloyd and Dortha Thompson, founded the company in 1946 and his father, Jim, took the reins in 1969. Randy took over operations of the Boonsboro, Maryland, business in 1996 at the age of 27 and began to grow it slowly.

After making the decision to grow strategically and rapidly through acquisitions, the ThompsonGas team began to acquire other family-operated suppliers of appliances and propane gas for commercial and residential customers. They purchased 27 companies between 1996 and 2012 and became the 18th largest distributor in the United States in 2012.

Initially, ThompsonGas identified potential acquisition candidates and pursued them. More recently, owners wishing to sell have begun to court ThompsonGas. This process has yielded a market footprint across the Eastern United States.

The third generation of the Thompson family created an entrepreneurial opportunity from an existing business.

Source: Courtesy of Thompson's Gas & Electric Service, Inc.

pitfalls and problems. Thus, **due diligence**, which is the exercise of reasonable care in the evaluation of a business opportunity, is vital. You have to sift through the story the seller and/or broker is telling you to discover the reality of the situation. Whether there is unintentional failure to disclose the full and true nature of conditions or a deliberate fabrication of information, the burden is on the buyer to identify the issues. Unlike the Franchise Disclosure Document, no standard, federally regulated disclosure is required, so discovery is up to the buyer and his or her attorney and accountant.

due diligence the exercise of reasonable care in the evaluation of a business opportunity.

Due diligence requires that the buyer acquire a broad range of information about the business, starting with the background information from the seller and through personal observation. Today, a quick scan of the Internet for information on the company and/or owner can provide ready access to information such as customer satisfaction/dissatisfaction, press coverage, and legal issues. Outside parties can provide a more complete picture of the firm. For example, bankers, suppliers, employees, and customers may provide realistic assessments and data. However, inconsistent or conflicting information, refusal to provide contact names, or hesitancy to open up to questions are all signs of potential problems and should be heeded.

If you want to truly understand a potential acquisition, information from stakeholders can prove invaluable. Internal documents, financial audits, and other information from the owners are critical to the process, but input from suppliers, customers, and employees helps to create a complete picture. It is perfectly appropriate to request lists of current and former suppliers, customers, and employees, both satisfied and dissatisfied, to interview. You are likely to get more of the truth about the business from its stakeholders. However, take care to avoid disclosing the potential sale if the current owner is protecting that information.

Part of the due diligence process should be to identify the real reason the owner is selling. Whereas people may offer such explanations as retirement, illness, relocation, or change of heart, the real answer may be something less benign. Common undisclosed reasons to sell a business are:

- lack of sufficient cash flow,
- unprofitability,
- difficulty in finding and retaining necessary staff,
- loss of exclusive franchise rights,
- pending changes in zoning or traffic patterns,
- changing industry or market conditions that will limit growth potential,
- entrance of new competitors,
- desire to start a new, competitive business in a better location, and
- pending or active litigation.

By completing the due diligence process, a prospective buyer may find that none of these negative circumstances exists and will feel comfortable making the purchase. However, it is better to find out about any potential pitfalls in advance and to address them than to receive unpleasant surprises after the purchase is final.

You can expect to receive information from a business broker and are well within your rights to request whatever information you require to make your decision. Sellers may be hesitant to disclose too much information to potential buyers because of concerns about competitive issues or the potential damage of disclosure should the sale not go through. They may require a signed **nondisclosure agreement**, a legal document enumerating the type of information that is to remain confidential.

nondisclosure agreement a legal document enumerating the type of information that is to remain confidential.

The prospective buyer can and should request full disclosure of all aspects of the business that pertain to its potential success. **Exhibit 3-3** lists

Exhibit 3-3 *Records and Information for a Prospective Buyer to Review*

- Financial statements, audited if available, for the previous three to five years
- Tax returns for the previous three to five years
- Bank deposit tickets for the past two years
- Employee records and turnover history for five years
- Ownership/shareholder structure and agreements, with any changes, for five years
- Statements of the business capital structure and assets, including nature of ownership
- Description of the products/services offered, with pricing and promotional materials
- Statements of condition of machinery, equipment, and physical plant, including any appraisals (followed by physical inspection)
- Inventory records (followed by physical inspection)
- Contracts, liens, leases, and other legal agreements
- Patents and records of patent-protection maintenance
- Other intellectual property protection, such as trademarks, copyrights, and sales marks
- Description of the technology in use, including computer software and dates of upgrades
- Disclosure of pending and active litigation, zoning, and regulations, as well as recently completed litigation
- Customer lists and sales records
- References from both satisfied and dissatisfied customers
- Supplier lists and references
- Credit and collections history in summary form and by account
- Statement of anticipated material changes
- Noncompete agreements

the records of information a buyer should request and review during due diligence. These are highly sensitive data for a business owner and may not be made readily available. Recognize that you have to be able to access any organizational documents, contracts and leases, financial statements, and tax returns to even consider purchasing a business. The more of the other items you can review, the better, particularly if you sense or observe something that may be problematic.

With this information in hand, you can work with skilled professionals, such as attorneys and accountants, to piece together a more realistic view of the business opportunity.

Determining the Value of a Business

Learning Objective 4
Learn how to determine the value of a business.

The valuation of a business is a combination of art and science, ultimately a matter of arriving at a price and set of terms that both the buyer and seller find acceptable. For a public company, valuation is the worth of the stockholders' equity. For a going concern with audited financials, the determination can be based on projected earnings and cash flows. For other going concerns, the process is more complex because the quality and reliability of the financial information is less certain. The primary methods of valuation are asset valuation, earnings valuation, and cash flow valuation.

asset valuation a method that analyzes the underlying value of the firm's assets as a basis for negotiating the price.

Asset valuation is a method that analyzes the underlying value of the firm's assets as a basis for negotiating the price. The four most common standards are

1. ***Book value.*** Starting with the value of assets reported in the books and records of the firm as a reference point, the actual value will depend on its accounting practices, such as allowances for losses and depreciation.

2. ***Adjusted book value.*** This takes into account any of the discrepancies identified in the calculation of book value and looks at the actual market value versus the stated book value. Intangible assets are often excluded in this method.
3. ***Liquidation value.*** This is a determination of the net cash that could be obtained through disposing of assets via a quick sale, with liabilities either paid off or negotiated away. It also includes the cost of liquidating. Neither buyers nor sellers are particularly interested in establishing a price based on liquidation, but it does establish a "floor," or minimum value, for the firm.
4. ***Replacement value.*** This is the determination of the cost of newly purchasing the assets, as would be required to start up the firm. This is also used more as a point of reference than as a pricing option.

Earnings valuation is a method that assesses the value of the firm based on a stream of earnings that is multiplied either by an agreed-upon factor (the capitalization factor) or by the price/earnings ratio (for a publicly traded company). As with any methodology of this nature, the challenge is how to determine the variables. Three ways of looking at earnings are

earnings valuation a method that assesses the value of the firm based on a stream of earnings that is multiplied either by an agreed-upon factor (the capitalization factor) or by the Price/Earnings ratio (for a publicly traded company).

1. ***Historical earnings.*** Start with the value of earnings reported in the books and records of the firm over multiple years. This can then be adjusted for items that will distort earnings, such as salaries of family members or depreciation. Historical earnings can be valid if future earnings can be reasonably projected as a result.
2. ***Future earnings under current ownership.*** This considers additional information that is available above and beyond historical earnings, such as economic changes, the competitive environment, and new products and services that have been introduced.
3. ***Future earnings under new ownership.*** This is a determination of the projections you make according to the changes you plan to implement. This may be the upper limit of what you are willing to consider.

In addition to determining which type of earnings to use, valuation will depend on which measure of earnings is selected. Will it be before or after taxes? Will it be earnings before interest and taxes (EBIT) or operating income? Which one is selected may make a significant difference in the valuation. It is traditional to use the after-tax earnings value without extraordinary items. However, if the new owner will have a different financing structure, using EBIT may be best. Ultimately, a price must be negotiated to the satisfaction of both the buyer and seller.

Another method of arriving at the worth of a business is to calculate the **cash flow valuation**, using projected future cash flows and the time value of money to arrive at a figure. This requires assessing the future expectations of cash flows from the business and applying financial calculations to arrive at the current value. It is less likely to be used for an entrepreneurial venture, but may be considered as an option.

cash flow valuation a method of calculating the worth of a business by using projected future cash flows and the time value of money.

Whatever value is calculated through quantitative methods, the final price should also reflect nonfinancial variables. While performing due diligence, you gathered information regarding the market space, the competitive environment, the legal and regulatory status of the firm, and any pending changes in the physical environment or labor situation, or need for investment in plant, property, or equipment. The value of customer goodwill must be factored into the price, and the competitive and legal environments also have an impact on pricing. The offer price and the maximum amount you are willing to pay should encompass all of the factors you have identified. This price will have to be tempered by what you can afford.

Negotiating and Closing a Purchase

Learning Objective 5

Learn how to negotiate and close the deal.

Once you complete your research, perform due diligence, and decide that you would like to purchase a particular business, it is time to negotiate the final price and terms of the sale and close the transaction. Whereas it is the objective of both parties in the negotiation to reach an agreement, their respective goals are very different. As the buyer, you are working to secure the best price possible, to reduce your initial investment capital costs and maximize returns. The seller is working to recoup as much money as possible through the sale. Remember, the price you pay should be no greater than you determined in advance. It is better to have invested the time and resources and then walk away from a deal that is not the right fit than to pursue it and find that you cannot reach your goals.

When determining the price and terms of the sale, it is essential to clearly establish what is being purchased—assets only or the business as a whole. An asset sale reduces the buyer's liability because the outstanding debts and any undisclosed or unknown liabilities remain the seller's responsibility. In a whole business sale, the buyer acquires all the assets and liabilities of the company, known or unknown. You may also complete a purchase of the whole business and address the liability issue through an indemnification clause in the sales contract.

In addition to the stated price of the business, the terms of the sale will be a major factor. Will the previous owner hold a note payable on all or part of the purchase price? Under what repayment terms? Does a noncompete agreement restrict when and where the seller can open the same kind of business? Is the seller remaining with the business for a specified amount of time to perform particular duties? Sometimes a seller may want a quick sale and wish to cut all ties. In other situations, there may be tax advantages to having a different structure. This needs to be clearly spelled out in the sales contract.

All of the terms and conditions should be agreed on, with appropriate professional counsel for all parties, prior to the formal closing date. You should clearly understand all legal agreements and have them either drawn up or reviewed by your legal counsel. The investment in professional advice prior to the sale can be crucial. Once the closing is complete, you will have signed a number of important legal documents, including a bill of sale, any financing contracts, and other agreements. You will now be the owner of an operating business!

Buying into a Business over Time

One option that may permit a current owner to separate from a company gradually, receive a stream of payments, and support customer loyalty is purchasing a business over time. You may create such an arrangement in a variety of ways. Typically, the future owner joins the existing company with gradually increased responsibility and equity. This permits time to more fully understand the existing operation while the owner is still present and active and allows for a smoother transition. As with any purchase agreement, it must be carefully structured to protect all parties.

Family Business as an Entrepreneurial Opportunity

family business a firm that has two or more members of the same family managing and/or working in it and that is owned and operated for the benefit of that family's members.

Much has been written about start-ups, franchises, and business acquisitions as entrepreneurial paths. Joining a **family business**, a firm that has two or more members of the same family managing and/or working in it and that is owned and operated for the benefit of that family's members, can present an opportunity for entrepreneurial success as well.

Whether it is the second generation or the tenth, there may be significant room for innovation, growth, and wealth building. For example, when Alan Levin became president and CEO of Happy Harry's Discount Drugs in the late 1980s to fill a void left by the unexpected death of his father, Harry, he began an adventure that led to expansion from a handful of stores to 76 outlets 20 years later, when he sold the firm to Walgreen's. Clearly, Alan had found entrepreneurial opportunity in a family business. There was ample opportunity for fostering entrepreneurial energy and talent.

Alamy Images

With a family business, much like the acquisition of any going concern, there is a chance to build on its strengths and to turn around problematic aspects. The greatest difference is that the changes will benefit the family and not only the buyer. A sound core business can provide a solid foundation for growth and expansion. If you join a family business in which your insights and energy are appreciated and supported, you can be part of the team that has built upon prior success. If the family business is floundering, perhaps suffering from sales decline, cash flow challenges, or other factors that threaten its viability, you can bring a fresh perspective and an additional skill set to the firm.

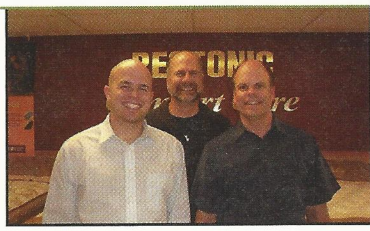
Learning Objective 6

Recognize joining a family business as an entrepreneurial pathway.

As with participating in any venture, and perhaps even more so because of the family aspect, you should proceed with your eyes wide open when joining a family business. Your role and the roles of others in the company should be clearly defined, as should your compensation and participation in profits and ownership. How you will work with one another should be discussed frankly to prevent miscommunications that can lead to permanent breakdowns in family relationships. To the extent that it is viable, conduct your due diligence as if you were purchasing a business from an unrelated party, but recognize that the very process of exploring the opportunity must be carried out with family relationships in mind.

Step into the Shoes . . .

Putting Spring into a Third-Generation Business



Oregon Mattress Co.

Brothers Tom and David Walker grew up at the Oregon Mattress Company in Newburg. Their grandfather, Cecil Austin Walker, founded the company in 1932, and their father, Richard, operated it into the 1990s. Tom and David worked with their father for a number of years to expand the business and enhance its overall viability. They moved from producing under the Lady Americana label to Restonic, a well-respected national brand, and Sleep EZ, their own brand.

Since 2009, Oregon Mattress opened five national brand factory outlet stores featuring mattresses produced in its Portland-area factory. The BedCo Mattress Superstores are located in Newburg, Lake Oswego, Cedar Hills, Tigard, and Happy Valley. The Walkers saw an opportunity to increase their share of the local market through direct retail sales of locally produced mattresses, including hard-to-find custom sizes and shapes, and their signature round beds. Now, as the fourth generation of Walkers (TJ Walker is the Director of Operations) joins Oregon Mattress Company, the firm is bouncing back in a weak economy.

Source: Courtesy of Oregon Mattress Company.

Perhaps the notion of joining a family business has been appealing from a very young age. Perhaps it is best to experience working in other businesses or fields of endeavor and turning to the family business later. Perhaps you will be drawn into the business because of a family emergency or tragedy. Regardless of the point of entry or reason, your best entrepreneurial opportunity may lie within the family business.

Chapter Summary

Now that you have studied this chapter you can do the following:

1. Understand the potential benefits of buying a going concern.
   - Start-up can be quicker and easier.
   - Reduced risk results from the established business structure and relationships.
   - The potential to identify and purchase a business at a bargain price exists.
2. Identify potential drawbacks of purchasing a business.
   - The current owner may fail to disclose negative information regarding the firm's condition.
   - The business may be a poor fit for the buyer.
   - Pitfalls may be avoided through a thorough due diligence process and use of qualified professional counsel.
3. Learn how to identify and evaluate purchase opportunities.
   - Identify personal goals and objectives to create the best match.
   - Use the many resources available to identify prospective purchases.
   - Perform due diligence to secure the most complete and accurate information.
4. Learn how to determine the value of a business.
   - Use asset, earnings, and/or cash flow valuation methodologies to arrive at a range of potential prices.
   - Consider the spectrum of nonfinancial factors in the price.
   - Arrive at offer and maximum price before entering the negotiations.
5. Learn how to negotiate and close the deal.
   - Recognize the mutual goal of making the transaction happen, despite differing individual goals.
   - Negotiate a price and set of terms that is satisfactory to all parties.
   - Hold a formal closing and complete all legal documents with the support of qualified legal and accounting counsel.
6. Recognize the joining of a family business as an entrepreneurial pathway.
   - A family business may have the potential to foster entrepreneurial energy and talent.
   - A sound core business provides a solid foundation for future success.
   - A floundering family business offers a chance to turn around the company and benefit the entire family.
   - Sometimes an entrepreneurial opportunity is right in front of us; we just have to recognize it.

Key Terms

asset valuation, 64
business broker, 61
cash flow valuation, 65
due diligence, 63
earnings valuation, 65
family business, 66
nondisclosure agreement, 63

Entrepreneurship Portfolio

Critical Thinking Exercises

3-1. What are four reasons to purchase a business rather than start up a new one?

3-2. Describe the type of business you would consider buying. Why did you choose it?

3-3. What are some red flags you might discover during due diligence?

3-4. How can entering a family business be a path to entrepreneurial success?

Key Concept Questions

3-5. Define due diligence and list some of the information to gather and analyze during the process.

3-6. Explain three ways businesses can be valued.

3-7. Describe the potential problems in buying a business.

Application Exercise

You have been considering going into business for three years and have saved $10,000 toward this dream. Since graduating from college two years ago, you have worked full time at a bank as a credit analyst and part time at a bookstore. These jobs have given you some perspective on financial services and retail trade. Now, you are ready to dig in and find a business to buy or start.

3-8. How will you decide what type of business to own (industry, geography, lifestyle, technology, etc.)?

3-9. Why would you (or would you not) weigh the option of buying a business?

3-10. Identify three possible sources of information on businesses for sale and find two possibilities from each. List the information that is provided on these six businesses.

3-11. Select one of the businesses and explain why it interests you as a possible investment.

Exploring Online

3-12. Perform a search of business brokers through an Internet search engine of your choice. What are the first five listings (excluding the sponsored links)?

3-13. Visit one of the Internet resources listed in **Exhibit 3-1**. Search for businesses for sale. Look at convenience stores, auto repair shops, or restaurants. Answer the following:

a. Which site and business type did you select?

b. How many businesses were listed for sale in your category?

c. Were there categories of businesses under the main search category? If so, what were they?

d. Examine one of the businesses for sale and record the information provided.