

ENTREPRENEURSHIP AND DESIGN THINKING

LECTURE 5: BUYING AN EXISTING BUSINESS

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Introduction

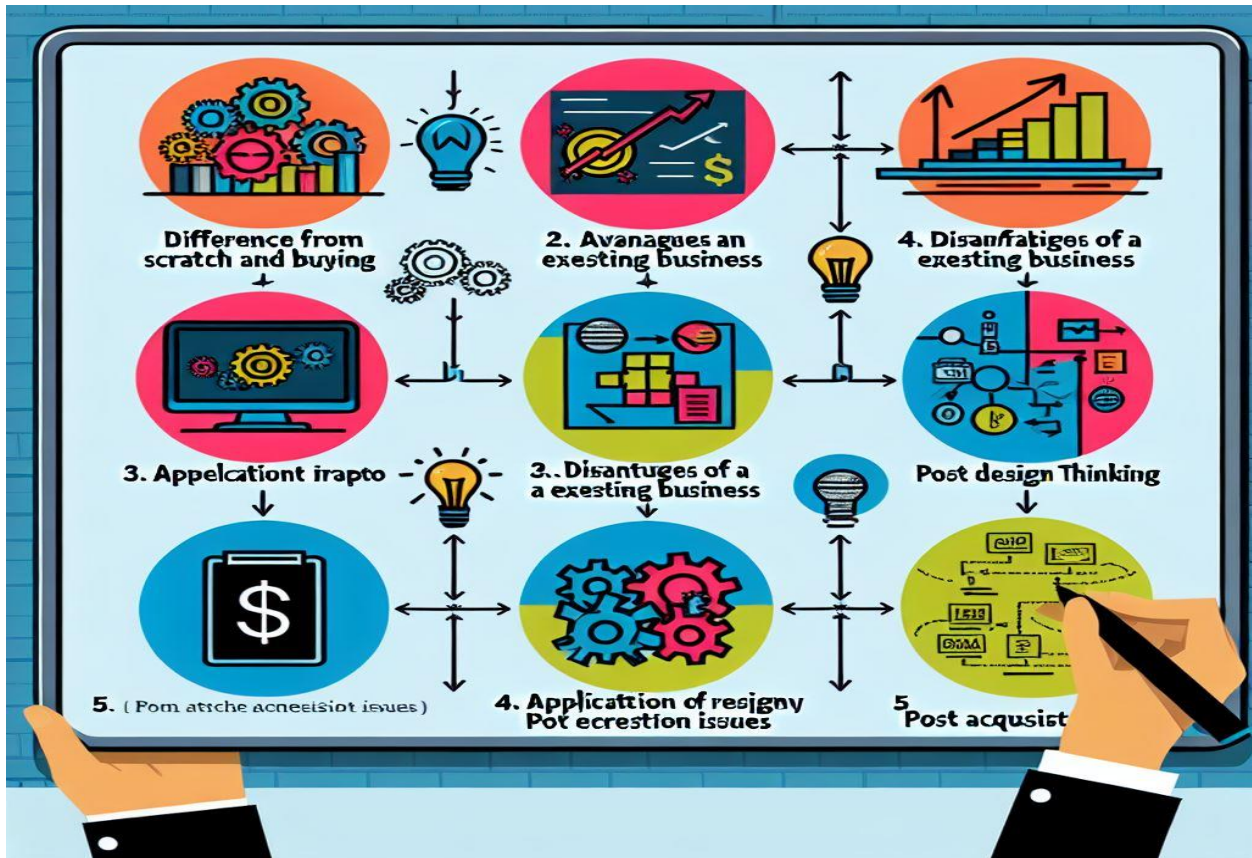
- In the previous lecture we looked at franchising as a form of business ownership that can help an entrepreneur get into business quickly.
- In this lecture, we will look at a topic that is closely tied to franchising, buying an existing business.

Learning Outcomes

- Differences between starting a business from scratch and buying an existing one
- Enumerate advantages of buying an existing business
- Point out the disadvantages of buying an existing business
- Apply design thinking approach to buying an existing business
- Assess post-acquisition integration and management

Overview

- Buying an existing business means acquiring control and management in an existing business, a business that has been operations.
- This often entails its assets, customer base and brand reputation.
- When this happens there are two options that are likely to happen; one is that the new acquiree may change a few things or everything as far as employees and brand is concerned.



- Alternatively, the new owner(s) may decide to go with the business as it is.
- Acquiring an existing business, as was the case with franchising, allows the new owner to get into business easily and quickly but also comes with certain risks, we will look at these at a later stage.
- Unlike starting one from scratch, buying an existing business allows the new owner to have access to an existing customer base, employee, proven business model, and established revenue streams.

When is this Strategy Applicable?

- When you want fast market entry and less setting up
- When you want to diversify your revenue stream
- When you already have an existing business, and you want to expand quickly

Push for Buying an Existing Business

- **Quick Start up:** Since the business is already in existence, it allows for immediate return on investment.
- **Risk Reduction:** By buying an existing business an entrepreneur is in a position to lower the risk, or the uncertainty involved in starting a new business, where you are not certain of getting customers.
- **Proven Business Model:** As was the case in franchising, in buying an existing business the entrepreneur will have observed and indeed satisfied that the current model of business has been successful.
- **Brand Recognition:** Success of an existing business could be seen or attributed to its brand, and therefore an entrepreneur has the advantage of riding on this.
- **Existing Revenue Streams:** The acquirer- entrepreneur has immediate access to the existing revenue streams and can start “counting money”.
- **Existing Channels:** The acquirer has immediate access to the existing distribution channels such as distributors and retailers, this is usually a huge item in determining business success
- **Access to Existing Customer relationships:** The new business can ride on the established
- **Access to Existing Partners:** The new business will not struggle to create linkage with partners as this is also established.

Disadvantages of Buying an Existing Business

- **Reputational Baggage:** The new business will have to bear with any reputational issue the existing business has with its own constituents. Issues such as negative review or business past performance

- **Hidden debts and liabilities:** It may not be clear from the onset how much the existing business may have not disclosed to the entrepreneur. This could be in the form of unpaid loans, pending taxes or court cases. All these might come haunting the new owner.
- **Overvaluation:** At times, the asking price may be higher than the true value or the market price of the business. An overvalued business makes it harder to achieve profitability.
- **Dependency on Key Personnel:** In some cases, you may have scenarios where the existing business's success was solely dependent on one person, and when they are plucked out, it might affect the operation of the business.
- **Outdated Process and Technology:** The existing business may be operating using outdated systems and technology that might be costly to upgrade for the new owner.
- **Expensive Relationships and Contract:** It is possible that the new business will be forced to stick with earlier established contracts and relationships and where there is inflexibility on changing them, they might be very expensive.
- **Possible Resistance to Change:** The existing employee often than not they might be apprehensive to changes introduced by the new owner. This may derail the progress.
- **Cultural Misalignment:** Whenever a merger or acquisition happens, there is a likelihood of cultures clashing between the acquirer and the acquiree. Which if not resolved well may affect the learning of the new entity.
- **Unclear Intellectual Property:** The existing business may have unclear, outdated or easily replicable intellectual property, which may therefore be of no relevance in as far as building competitive advantage.
- **Knowledge Transfer Issue:** The transition of organizational knowledge from the current owner to the new owner or employee of the latter may also present a challenge. The honesty and transparency required in this may not always be forthcoming.

Use of Design Thinking in Buying an Existing Business

Design thinking as a tool for solving problems can be used when an entrepreneur is faced with the question of buying an existing business. Here are some of the steps that one can take in application.

- Through **understanding** and **observing** phases the entrepreneur can have empathy with the current customers, employees, and other stakeholders. Having a clear understanding of their needs, pain points and expectations.
- Through **synthesis**, the entrepreneur would be able to identify key problems the current business could be having through the empathy phase
- Through the **ideation** process, the entrepreneur would be able to develop diverse ideas to address the identified problems or gaps. This could include new business processes, customer service enhancements, and/or product improvements.
- After idea selection, the new business could develop a **prototype** of the proposed solution or model, for instance a new business model, a new customer experience.
- This can be further **tested** and improvement sort before eventual roll out.

Evaluation of an Existing Business

In carrying out an evaluation of an existing business the following steps are necessary.

- **Market and Competitive Analysis:** This helps an entrepreneur to know the place and position of the business visa viz the competitors
- **Financial Assessment:** Here the focus is on the business performance as may be captured by statements such as balance sheets, income statements, and cashflow statements.

- **Legal Compliance:** The concerns here are whether the business is properly incorporated, if there are ongoing legal issues, or pending contracts that the new owner will have to assume.
- **Operational Check:** This is basically a review of the processes, systems, equipment and current technology, seeing if they are up to date or outdated.
- **Asset Valuation:** This represents the professional physical appraisal of the business' assets as well as the intellectual property it could have.
- **Employee Stock:** In this evaluation, both their roles and responsibilities need to be assessed. It might entail a review of the organizational structure and contracts that are in existence.
- **Customers and Suppliers Review:** Taking stock of both current customers and suppliers and the existing relationships is important before one can take over management.
- **Professional advice:** Finally, before the deal is negotiated and signed it is important to seek opinions from the likes of auditors, lawyers, and accountants to give their opinions on the findings on all the above
- After a green light has been given, then negotiations and finalization can be done.

Post-Acquisition Integration and Management

- As mentioned earlier, whenever two businesses come together either through merger or acquisition, there are challenges that are likely to emerge. Cultures, systems, processes, mission and goals may delay the take-off. An entrepreneur must therefore be keen and aware of such challenges and lay down possible solutions for each.
- A greater part of this lies in change management, but also during the due diligence process where an alignment is sought in terms of vision and mission and that of the cultures before the marriage is consummated.

Topic Review

- The topic looked at the key aspects of buying an existing business, we started by looking at how it differs from starting a new business.
- The topic further looked at what pushes an entrepreneur into buying an existing business and equally challenges that such a move would result in.
- Finally, we emphasized the need for due diligence to be done to reduce the risk of post-acquisition.
- In the next topic, we will look at Business Model Canvas which is a common tool in visualizing a business model.