Learning Objectives

1. What is the role and structure of the small business within the U.S. economy?
2. What are the traits of an effective entrepreneur, and how do these characteristics often lead to business success?
3. What are the advantages and disadvantages of franchising within the context of entrepreneurship?
4. Why is a business plan crucial to small business success, and what factors lead to small business failure?
5. How do resources, including the Small Business Administration (SBA), mentoring sources such as the Service Corp of Retired Executives (SCORE), business incubators, and advisory boards, provide assistance and guidance to small business owners?
6. What are the potential benefits and drawbacks of each major source of small business financing?
Small Business

• A small business:
  - Is independently owned and operated
  - Is not a dominant force in its field
  - In general, has fewer than 500 employees
  - Has an average of $6.5 million annual revenue
    (in retail and service industries)
Small Business and the Economy

- In the U.S., small businesses
  - Provide 40.9 percent of private sales in the country
  - Account for more than half of America’s economic output
  - Account for approximately 50 percent of the private workforce
  - Represent 97 percent of all U.S. exporters
Small Business Contributions

• Foster innovation
• Help bigger companies:
  - Supply products and services to the larger companies that they do not or cannot supply
• Help consumers:
  - Supply products and services that large companies cannot or will not provide
Small Business and the Workforce

• Create over 60% of new jobs each year
• Employ many who do not fit into a traditional corporate structure
• Provide opportunities for women and minorities

<table>
<thead>
<tr>
<th></th>
<th>Women</th>
<th>African Americans</th>
<th>Hispanics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of businesses owned by</td>
<td>5.3M</td>
<td>928,000</td>
<td>1.6M</td>
</tr>
<tr>
<td>Percent growth in number of</td>
<td>10%</td>
<td>36%</td>
<td>109%</td>
</tr>
<tr>
<td>businesses (2000-2007)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The Impact of Technology on Small Business

• The personal computer and the Internet have:
  - Created entirely new business opportunities
  - Made starting a new business easier

• Over 80% have a home page

• 33% promote their products through e-mail marketing

• Impact of Social Media
Small Business Structures

What kind of structure should I choose for my small business?

• Sole proprietorship
• General partnership
• Limited partnership
• Corporation
• Limited Liability Company (LLC)
Entrepreneur Basics

• What is an entrepreneur?
• Traits of successful entrepreneurs:
  - Innovative
  - Risk takers
  - Motivated to succeed
  - Flexible and self-directed
  - Work well with others
  - Good leadership skills
  - “System thinkers,” seeing the whole process rather than just individual pieces of it
Types of Entrepreneurs

- Lifestyle
- Micropreneur
- Home-based
- Internet
- Growth
- Intrapreneurs
- Social entrepreneurs and social intrapreneurs

Mark Zuckerberg, Facebook
Franchise Basics

- Franchise
- Business opportunities
- Franchiser
- Franchisee

![Figure 5.6: Start-up Costs and Franchise Facts](image)

<table>
<thead>
<tr>
<th>Costs &amp; Fees</th>
<th>Subway</th>
<th>McDonalds</th>
<th>Jazzercise</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Investment:</td>
<td>$78,600–$238,300</td>
<td>$950,200–$1,800,000</td>
<td>$3,000–$75,500</td>
</tr>
<tr>
<td>Initial Franchise Fee:</td>
<td>$15,000</td>
<td>$45,000</td>
<td>$500–$1,000</td>
</tr>
<tr>
<td>Royalty Fee:</td>
<td>8%</td>
<td>12.5%</td>
<td>Up to 20%</td>
</tr>
<tr>
<td>Term of Agreement:</td>
<td>20 years</td>
<td>20 years</td>
<td>5 years</td>
</tr>
<tr>
<td>Renewal Fee:</td>
<td></td>
<td></td>
<td>$45K</td>
</tr>
</tbody>
</table>
Franchising Pros and Cons

**Pros**
- Recognized brand name
- Proven system of operation
- Strength in numbers
- Initial training is part of the deal
- Marketing support is provided
- Market research is often provided

**Cons**
- Lack of control
- Start-up costs
- Workload
- Competition
- Share problems occurring elsewhere in the franchise
## Questions to Ask Before Buying a Franchise

<table>
<thead>
<tr>
<th>Competition</th>
<th>Questions to Ask the Franchisor</th>
<th>Questions to Ask Other Franchisees</th>
</tr>
</thead>
<tbody>
<tr>
<td>• What is the competitive advantage of the product/service?</td>
<td>• How is your system better than competitors’?</td>
<td>• How long have you been in business?</td>
</tr>
<tr>
<td>• What makes the business more attractive to an owner and more attractive to a customer?</td>
<td>• How does your business match up?</td>
<td>• Does your location meet your customers’ needs?</td>
</tr>
<tr>
<td></td>
<td>• Who are your competitors?</td>
<td>• Who selected the site?</td>
</tr>
<tr>
<td>Franchise System</td>
<td>• How time tested and standardized is the franchise system?</td>
<td></td>
</tr>
<tr>
<td>• What franchise system is used and how does it work?</td>
<td>• How long has the franchise been in business and what improvements has the franchise company made recently?</td>
<td></td>
</tr>
<tr>
<td>• How long has the franchise been in business and what improvements has the franchise company made recently?</td>
<td>• How is the relationship with the franchisor?</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• How were the initial training and ongoing training and ongoing support?</td>
<td>• How are the marketing, advertising, and promotional programs handled?</td>
</tr>
<tr>
<td></td>
<td>• How are the marketing, advertising, and promotional programs handled?</td>
<td></td>
</tr>
<tr>
<td>Support and Training</td>
<td>• How much support does the franchisor give the franchisee?</td>
<td></td>
</tr>
<tr>
<td>• What is the initial and ongoing training?</td>
<td>• Are there toll-free help lines, field support, annual meetings, local meetings, purchasing programs, and marketing promotion?</td>
<td></td>
</tr>
<tr>
<td>• Are there toll-free help lines, field support, annual meetings, local meetings, purchasing programs, and marketing promotion?</td>
<td>• Are you pleased with earnings?</td>
<td></td>
</tr>
<tr>
<td>Financial Strength</td>
<td>• What is the financial strength of the company and the experience of management?</td>
<td>• Is volume growing?</td>
</tr>
<tr>
<td>• How much revenue comes from franchise fees and how much revenue comes from royalties?</td>
<td>• Have there been lawsuits and/or arbitration?</td>
<td></td>
</tr>
<tr>
<td>• How has the stock performed?</td>
<td>• If so, how have they been resolved?</td>
<td></td>
</tr>
<tr>
<td>Franchise Relationships</td>
<td>• How important is the franchisee to the franchise?</td>
<td>• Do you have second thoughts (would you do this again)?</td>
</tr>
<tr>
<td>• How can they describe the relationship with the franchisor?</td>
<td>• Would you own more units?</td>
<td></td>
</tr>
</tbody>
</table>

Buying an Existing Business
Pros and Cons

**Pros**
- Ease of start-up
- Existing customer base
- Financing opportunities

**Cons**
- Purchase price may be high
  - Valuing goodwill may be difficult
- Inheriting the previous owner’s mistakes
- Unknowns in transition
  - Existing employees, management, customers, suppliers, or distributors will continue to work with the new ownership
Due Diligence

• Research and analysis of the business to uncover any hidden problems associated with it

Things to Consider Before Buying a Business

Initial questions to ask:
• Why is the business for sale?
• What do current customers say?
• Are there opportunities for growth? How much time does the current owner put into the business?
• Who is the competition?

Due Diligence Checklist
• Get an independent valuation of inventory and equipment.
• Have an accountant review the financial statements for the past three years.
• Have a lawyer analyze pertinent business documents- property leases, employment contracts, and so on.
• Talk to suppliers to see if they will continue to supply the business when ownership changes hands.
• Check for lingering or festering hazardous waste problems. They’ll become your responsibility as the new owner.
Why Do Small Businesses Fail?

- Accumulating too much debt
- Inadequate management
- Poor planning
- Unanticipated personal sacrifices

![Figure 5.7: Average Survival Rate of Small Business Start-ups](image)
Business Plans

Company Information
• Mission Statement
• Current Status
• History
• Management Team

Marketing Plan
• Competitive Analysis
• Pricing
• Distribution
• Promotion and Brand Development

Operational Plan
• Staffing
• R & D
• Manufacturing Plan
• IT Plan

Financial Plan
• Current Financing
• Funding Needs and Plans
• Financial History
• Financial Forecasts
• Valuation

Risk Analysis
• Risk Evaluation
• Risk Management Plan
Where Do Small Business Owners Go for Help?

• Small Business Administration (SBA)
• Service Corp of Retired Executives (SCORE)
• Mentoring resources
• Business incubators
• Advisory boards and partners
Financing Considerations

• Cash
  - Personal savings
• Credit
  - Friends and family
  - Credit cards
• Banks and other loans
• Venture capitalists
• Angel investors
• Small Business Investment Company (SBIC)
Chapter Summary

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