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CHAPTER SIX

AVENUES OF ACQUIRING A BUSINESS

REVISED NOTES

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This chapter consists of 11 pages.

CONTENT DETAILS FOR TEACHING, LEARNING AND ASSESSMENT PURPOSES

AVENUES OF ACQUIRING A BUSINESS

Learners must be able to:

- Explain/Discuss/Justify/Motivate the reason why entrepreneurs may decide to purchase an existing business.
- Define/Elaborate on the meaning of franchising, outsourcing, and leasing
- Outline/Mention/Discuss/Explain/Describe the advantages, disadvantages, and contractual implications of the following business avenues:
    - Franchising
    - Outsourcing
    - Leasing
- Identify/Name business avenues from scenarios/case studies/statements.
- Conduct research on the viability and benefits of franchising, outsourcing, and leasing

Terms and Definitions

TERM/CONCEPTS	DEFINITION/MEANING
Franchising	When a person or a business gives another business or person the right to sell the same goods or services subject to certain criteria or regulations. a marketing concept whereby the franchisor licenses the use of its business model, its brand, know-how, procedures, intellectual property, and rights to sell its branded products and services to a franchisee. In return, the franchisee pays certain fees and agrees to comply with certain obligations.
Franchisee	individual who purchases the right to use the trademark or business model. a person who pays a fee to the franchisor for the right to use the trademark and proprietary knowledge.
Franchisor	Individual who sells the right of the trademark or business model in return for franchise royalty fee. (
Goodwill	The amount of money the business owner wants for the good trade name he or she has built up, the customer base, the

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	branding of the business, etc.
Leasing	method where a business can pay for the use of an asset rather than buying it outright for itself. a contract outlining the terms under which one party agrees to rent goods or services owned by another party.
Lessor	Person or business who owns the assets someone who grants a lease to someone else. The lessor is the owner of an asset that is leased under an agreement to a lessee.
Lessee	a person who rents property or land from a lessor. The lessee is also known as the “tenant” and must comply with specific obligations as defined in the lease agreement.
Outsourcing	when a business buys goods or services from another business or pays another business to carry out a function instead of it doing it itself. an agreement in which one company hires another company or person to supply services or goods that could be done internally by the company’s employees.
Solvent	The value of the company’s assets exceeds that of the liabilities.
Liquid	The company has enough cash to pay daily expenses.
Profitable	a business is profitable when it is making or likely to make a profit. Profits are measured in money earned beyond expenses, so profitable businesses or transactions make money.

1 Reason why entrepreneurs may decide to purchase an existing business

Established business	An established business should not take up too much time to set up as all requirements needed to run the business is already in place.
Established customer base	An established business should have an existing customer base.
Established name and reputation	When an entrepreneur buys an existing business, it may come with goodwill from an established good reputation on the market. People are creatures of habit – if they have shopped at the same hardware store for several years, they will likely continue to shop there – even when a new owner takes over. It

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	is a good idea to state that the transfer of ownership includes the company's phone number, website and registered name.
Known market	The market research has already been done for an existing business, so the new owner can use that information to form any future plans.
Mentorship	Starting a business can be overwhelming. If you purchase an existing business, the owner may often be willing to stay on for an agreed amount of time to mentor and guide the incoming owner.
Cash flow	An existing business already has customers and continued cash flow. By comparison, a start-up can take a long time to attract new customers and become cash positive. Buying an existing business can offer greater security over working capital and help the new owner to improve cash flow sooner.
Financing	Many existing companies have three or more years of profitable financials that makes it easier to secure financing either from a traditional bank, government organisation, or venture capitalist.
Current Staff	Only one in ten start-ups make it past the second year and many businesses fail during growth as the business tries to hire more staff. Having trained staff in place can ensure a smooth transfer and contribute to the success of the business.
Market position	When an entrepreneur buys an existing business, it can increase its market position. Similarly, it can increase its customer base, market share, and resources.

2 Types of avenues of acquiring businesses

2.1 Franchising

2.1.1 Meaning franchising

- Franchising refers to the purchase of a business idea.
- The entrepreneur will obtain premises and the right to offer the same products/services, with specific rules and regulations as per the agreement.

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- Franchising is the practice of using another person's business model and it can be seen both as a marketing and a distribution.
- Franchising is a license to use the name, idea, and processes of an existing business in a specific geographic area
- A franchise is an agreement between a franchisor and a franchisee. According to a franchise agreement, the franchisee obtains the right from the franchisor to use the name and trademark of the franchisor and to sell the franchisor's products.
- Franchising involves two parties:
  - **Franchisor**-the person who sells the right to trade in the products/services.
  - **Franchisee**-the person who purchase the right to reproduce the idea by offering the same products/services.
- The franchisor grants the franchisee the right to distribute its products and trademarks for a percentage of gross monthly sales and a royalty fee.

Examples of a franchise

- McDonalds
- Kentucky Fried Chicken (KFC)
- Fish & Chips
- Food lovers
- Filling stations

2.1.2 Advantages and disadvantages of franchising

Advantages of franchising

- It allows businesses to buy a well-known brand which guarantees sales and good return.
- Purchasing a franchise is cheaper than starting a new business.
- Franchising reduces long-term financial risk.
- A business is based on a proven idea and the product and service are tried and tested.
- A franchisee can get support from the franchisor, which often includes training, advice, and marketing.
- Forms of financing that are not available to the public are often available to franchisees.
- Reduced long-term financial risk.

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- Purchasing a franchise could be cheaper than starting your own business.
- Businesses are able to use a recognised brand name and registered trademark, which helps with advertising and marketing.
- The systems/operations/goods and services are well established.
- There is often access to group support from other franchisees and a network of communication and legal advice.
- Established suppliers give bulk discounts as they form part of a larger group.
- The marketing and advertising costs are shared so they are often lower than for a non-franchised business.
- Management advice is often provided, so it is not necessary to be a business expert.
- The product is already well known in the market, which guarantees sales and good return.
- Franchisees benefit from lower costs due to centralised buying by the franchiser.
- Franchises offer the independence of a small business ownership supported by the benefits of a big business network.
- You do not necessarily need business experience to run a franchise. Franchisors usually provide the training you need to operate their business model. Franchises have a higher rate of success than start-up businesses.
- The marketing and advertising costs can be shared, so they are lower than for a non-franchised business.
- There is often access to group support from other franchisees and a network of communication and legal advice.
- An operational franchise is an established business so there is less financial risk.

Disadvantages of franchising

- Acquiring a franchise can be an expensive initial layout
- There are often restrictions in the agreement and terms of how the business should be operated.
- Many creative entrepreneurs feel limited as to how much they can grow/expand their ideas.

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- One poorly performing outlet may risk the reputation of the entire franchise.
- The brand could get a bad reputation through other franchisees.
- A large portion of profits is paid in royalties, and often the franchisors do not deliver on their promises.
- It is often difficult to sell a franchise/terminate a contract.
- The start-up cost many be a challenge without assistance from the franchisor.
- Too many outlets may flood a specific area.
- Franchisees have to pay royalties or a share of the profit to franchisors.

2.1.3 Contractual implication of franchising

- The franchisor and franchisee must sign a franchise agreement which is legally binding on both parties. The agreement must cover the following aspects:
  - Confidentiality clause.
  - Tax requirements.
  - Disclosure documents
  - Settlement of disputes
  - How to sell or transfer the franchise
  - Total investment
  - How to deal with trademarks, patents and logos.
  - Advertising policies
  - The initial duration of the franchise and any renewal rights.
  - The policies that govern the product or service.
  - Royalties and the dates of payment.
  - Termination clause and its consequences
  - Training and operational support provided by the franchiser
  - The obligations of the franchiser and franchisee
  - The nature and extent of the rights granted to the franchisee.
  - The form of ownership that the franchise will operate under
  - operation specifications like marketing strategy and pricing

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2.2 Outsourcing

2.2.1 Meaning of outsourcing

- Outsourcing is when a business buys goods/services from another business to do the job instead of the business performing the function themselves.
- Outsourcing is the business practice of hiring a party outside a company to perform services that were traditionally performed in-house by the company's staff.
- Companies use outsourcing to cut labour costs, and to reduce overhead expenses such as expenses for equipment and technology.

Examples of outsourcing

- IT outsourcing
- Legal outsourcing
- Security
- Cleaning
- Recruitment
- Transport
- Staff training
- Call centres
- Computer installation and maintenance
- Accounting functions such as managing salaries and wages.
- Catering services

2.2.2 Advantages and disadvantages of outsourcing

Advantages of outsourcing

- Outsourcing allows the business to focus on important business activities rather support activities.
- A business has access to resources and equipment for a specific function.
- The production team is often shortened and quality is often improved because specialists are performing the function for the business.
- A company is able to reduce costs as outsourcing can lead to a decrease in staff, remuneration, control and operating costs.

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- The business can focus on its vision /goals and to apply its staff more effectively in its core business.
- Improved access to skilled people as the outsourced work will be done by highly skilled people without the company having to employ them.
- Fixed cost and overhead costs are lower for the business.
- Outsourcing will provide continuity during periods of high staff turnover.
- On-site outsourcing will bring people with a certain skill set into the company, and existing employees can collaborate with them to gain new skills.

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Disadvantages of outsourcing

- Risk of losing sensitive data and the loss of confidentiality
- Risks such as bankruptcy and financial loss cannot be controlled
- Lack of organisational Learning and innovative capacity.
- Managing the outsource provider could be more difficult than managing employees.
- Confidential issues could be at risk if the information is given to another company who performs the function that is outsourced.
- Outsourcing can create a crisis for the business if the outsource provider suddenly terminates its contract.
- There may be a lack of personal care/quality as the business is not personally involved in the execution of the function
- Hidden costs and legal problems may arise if the outsourcing terms and conditions are not clearly defined.
- Losing management control of business functions mean that the business may no longer be able to control operations
- Not understanding the culture of the outsourcing provider and the location where you outsource to may lead to poor communication /lower productivity.
- Problems with quality can arise if the outsourcing provider doesn't have proper processes
- If important functions are being outsourced, an organization is mightily dependent on the outsourcing provider.
- Outsourcing provider may work with other customers, they might not give full time/ attention to a single company resulting in delays and inaccuracies in the work output.
- Labour unions are opposed to outsourcing, especially where labour brokers are used.
- If only part of the business operations are outsourced, current staff might feel threatened and staff morale may suffer.

2.2.3 Contractual implications of outsourcing

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- A contract will protect and regulate the rights and responsibilities of both parties involved. Some aspects that may be included in the contract are:
  - An exact description of the service/product.
  - The length or duration of the contract
  - A detailed description of the duties and the responsibilities of both parties.
  - Confidentiality clause to protect privileged information
  - Payment terms and conditions.
  - Penalties for not delivering the agreed services

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2.3 Leasing

2.3.1 Meaning of leasing

- A lease is a contract outlining the terms under which one party agrees to rent goods, such as equipment and technology, owned by another party. It allows the user (**lessee**) to make use of an asset, and guarantees the property owner or landlord (the **lessor**) regular payments for a specified period in exchange.

- Leasing is the method whereby a business pays for the use of an asset e.g. equipment, land, material etc.
- The person who owns the asset is known as the lessor
- The lessee is the person who uses the asset.
- The lessor will make the asset available to the lessee, who lease the asset in return for an agreed amount called leasing charges.
- The leasing fee usually includes a maintenance fee and insurance fee.
- The lessor has to repair /replace the asset if needed.
- This is a method gives businesses the option of obtaining the use of an asset for a certain period, instead of buying the asset

Examples of leasing

- Office equipment
- Vehicles
- Trailer
- Machines
- Clothing rental businesses

2.3.2 Advantages of leasing for the lessor

- Leasing improves the cash flow of the business.
- Leasing is regarded as an expense for the lessee and is therefore not regarded as debt.
- The lessor receives a continual rental income.
- The lessor can get quantity discount by buying goods in bulk to supply various lessees.
- The asset can be returned to the lessor when it is no longer needed.

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- Makes budgeting and planning easier and it provides better control over cash flow.
- Retains ownership of the asset, which can be sold to recover money at the end of the lease
- There is no large financial outlay as the cost is spread over a number of months/years.
- The lessor normally covers the maintenance/ replaces any damaged parts or equipment.
- There are tax advantages as rental payment are calculated as operating costs
- Leasing costs are tax deductible.
- It is easy to lease a better/ newer version of the product without the capital outlay.
- The assets can be returned to the lessor when it is no longer needed.
- The lessor is usually an expert in the field.
- Technicians are always on standby to offer advice and training.

Disadvantages of leasing

- The lessee does not own the asset.
- The lessor has control over the financial obligation of the lessee.
- Some leases require the lessee to maintain and repair the asset.
- A large amount of money is spent on an asset every month, the total of which is a lot more than what the asset is worth.
- Maintenance agreements are usually expensive and non-negotiable.
- The agreement cannot be ended without a penalty.
- The lessee is responsible for maintenance even though they do not own the item.
- The total monthly cost can be increased.
- The lessor may not be able to sell the asset after the lease if it has not been kept in good condition.
- The lessor is committed to the contract and may not reclaim the asset before the lease expires.
- The lessee is committed to the contract and may have to pay for the lease even if they have no further use for the item.

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- The lessee is bound by a contract.
- Lease expenses reduce the net income of a business.
- No added tax advantages can be derived from leasing expenses.

2.3.3 Contractual implications of leasing

- The lease agreement will indicate whether the lessee becomes the owner of the asset after the lease period for a fee or not.
- The following details must be stated on the lease agreement:
  - Names of the parties entering the lease agreement/contract.
  - Duration/Period of the lease
  - Detailed description of what is being leased.
  - Conditions of renewal
  - The monthly amount payable
  - Any conditions such as deposits, insurance and security
  - Details of how the instalment will be calculated.
  - Any specific conditions for renewing the lease at the end of the contract period.
  - The procedure and liability for legal costs if a dispute arises.
  - The procedure if the lessor or lessee become insolvent
  - Detail of insurance, maintenance and restrictive use, up-front payment and instalments.
  - The right to occupy an asset, for example, a property
  - The right to use the asset, for example, a delivery van
  - The responsibility to keep the asset in good order or condition
  - The responsibility of paying fees or rent on time

Example of a scenario on acquiring business avenues

WISE LWAZI VENTURING

Lwazi and his sons have realized that it is not always necessary to start a business from scratch. They approached an existing business and concluded a contract to be given a right to sell their similar products within some regulations. The younger son became smarter when he realised that their small items that require regular maintenance can make money for them by contracting it to another business. But his billionaire daughter proved to the world that it is effective when a business decides to focus on its vision and improve their quality by allowing specialists to perform other duties on their behalf.

- Identify THREE ways of acquiring a business avenue from the scenario above. Motivate your answer by quoting from the scenario

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Use the table below as a guide to answer this question

BUSINESS AVENUE	**MOTIVATIONS**
1.	
2.	
3.	

- Outline THREE contractual implications of EACH type of acquiring business avenues identified above
- Discuss the advantages of EACH type of acquiring business avenues identified above.

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