**Entrepreneurship**

**And**

**Small Business Management**

Homework 5

Chapter 7

Following are 20 questions: 16 multiple choice questions worth 4 points each and four open questions worth nine points each.

1) The due diligence process of analyzing and evaluating an existing business \_\_\_\_\_\_\_\_.

A) may be just as time consuming as the development of a comprehensive business plan for a start-up

B) helps to determine if the company will generate sufficient cash to pay for itself and leave you with a suitable rate of return on your investment

C) helps to determine what the company's potential for success is

D) All of the above

2) When done correctly, the due diligence process will \_\_\_\_\_\_\_\_.

A) reveal both the positive and negative aspects of an existing business

B) be time consuming and expensive

C) most often result in the purchase of the business

D) rarely prove to be beneficial

3) Advantages to buying an existing business that you do not have with a startup include \_\_\_\_\_\_\_\_.

A) greater access to venture capital

B) the opportunity to participate in a national advertising campaign

C) inventory is in place and trade credit is established

D) easy implementation of innovations and changes from past policies

4) Which of the following is a potential disadvantage of purchasing an existing business?

A) The employees inherited with the business may not be suitable.

B) The previous owner may have created ill will among the company's customers.

C) Equipment and facilities may be obsolete or inefficient.

D) All of the above

5) When evaluating the assets of an existing business, the inventory \_\_\_\_\_\_\_\_.

A) is always current and salable

B) usually appreciates over time, making the business a bargain

C) should be judged on the basis of its market value, not its book value

D) is usually stated honestly and does not need an independent audit

6) An entrepreneur who is considering purchasing a business is analyzing a company's accounts receivable. The following table summarizes her findings.

**Age of Accounts Amount Probability of Collection**

0 - 30 days $12,000 .96

31 - 60 days $ 4,000 .87

61 - 90 days $ 2,500 .71

91 - 120 days $ 1,400 .65

121+ days $ 800 .24

How much should this potential buyer be willing to pay for these accounts receivable?

A) Nothing; a buyer should never purchase existing accounts receivable.

B) $20,700

C) $17,877

D) Not enough information given to determine

7) The process of investigating the details of a company that is for sale to determine the strengths, weaknesses, opportunities and threats facing it is known as the \_\_\_\_\_\_\_\_ process.

A) hidden market

B) due diligence

C) skimming

D) business assessment

8) Which of the following is ***not*** a stage in acquiring a business?

A) due diligence

B) negotiation

C) valuation

D) transition

9) Negotiation take place \_\_\_\_\_\_\_\_.

A) throughout the five stages in acquiring a business

B) in the due diligence stage

C) in the valuation stage

D) in the transition stage

10) The letter of intent is a \_\_\_\_\_\_\_\_ document.

A) binding

B) nonbinding

C) transferable

D) final

11) When acquiring a business, the buyer should \_\_\_\_\_\_\_\_.

A) conduct a self-analysis of skills, abilities, and interests

B) develop a list of criteria that define the "ideal business" for the buyer

C) prepare a list of potential candidates that meet the criteria

D) All of the above

12) Which of the following is ***not*** a source for the hidden market?

A) Networking

B) Business brokers

C) Industry contacts

D) All of the above are sources for the hidden market

13) The \_\_\_\_\_\_\_\_ method establishes the value of a company by computing the book value of its net worth, or owner's equity.

A) earnings

B) market

C) balance sheet

D) multiples

14) The \_\_\_\_\_\_\_\_ method considers the future income potential of the business.

A) earnings

B) market

C) balance sheet

D) fixed price

15) The structure of the deal refers to the \_\_\_\_\_\_\_\_.

A) price paid

B) method of payment

C) terms and conditions of payment

D) legality of the process

16) Which of the following is ***not*** a document required to close the deal?

A) Letter of intent

B) Bill of sale

C) Asset purchase agreement

D) Non-compete agreement

**Open Questions**

1) Briefly describe the advantages and the disadvantages of buying an existing business. Cite and explain four of each.

2) Your friend Susan is considering purchasing an existing business. How would you explain to her what

* due diligence is,
* why it is important,
* and the critical areas of it?

3) Paige Dominick is considering purchasing an existing business. She has asked you to advise her on her purchase. How would you explain to her what a letter of intent is and why it is important?

4) Asset valuation is an important part of the due diligence process. Why?

**Answer:** A prospective buyer should evaluate the business's assets to determine their true value. The firm's inventory and other assets typically constitute the largest portion of a business' value, and potential buyer should not accept the seller's asking price blindly. The critical thing to remember here is that book value is not the same as market value. Value is determined in the market, not on a balance sheet. A buyer often can purchase equipment and fixtures at substantially lower prices than book value.