

FERNWOOD NRG ACQUIRES STUDIO 1313 HAIR DESIGN: A CASE STUDY

INTRODUCTION

About the Seller: Studio 1313 Hair Design was originally called Studio 1284. It is, and has always been, a community business and a gathering space for the Fernwood neighbourhood. The original owner founded the business and ran it successfully with a team of experienced and professional stylists for 18 years, before selling to Fernwood NRG.

About the Buyer: "Fernwood NRG is a social enterprising non-profit organization run by and for the residents of Fernwood, a neighbourhood in Victoria, BC." Fernwood NRG provides childcare programs, recreational activities affordable housing, and community gathering spaces for the residents of Fernwood.



STORY OF THE ACQUISITION

In 2013, the owner of Studio 1284, a long term ally and friend of Fernwood NRG's Executive Director, approached him in a crisis. The hair salon owner was upset because she had a falling out with her landlord, and she was worried that she would have to close her business as a result.

The ED proposed that she could rent a space for the business in a building that Fernwood NRG owned. She appreciated the offer, but she was planning on retiring in a few years and didn't want to take on the risk of signing a new lease and renovating the space.

The ED still wanted to preserve business, so he sought permission from his board of directors to propose that Fernwood NRG buy the hair salon, with one caveat: the previous owner would stay on as manager for a few years during the transition. Fernwood NRG had acquired property and started up a business in the past, but they had never acquired a business. This was a first for the organization.

When the ED proposed the idea to the owner of Studio 1284, she was excited by the idea. She thought it over and decided to take the offer. At that time of the deal, the business value was the client list, staff and inventory. The two parties were able to work out a deal that was heavily focused on a management contract and not on price. Fernwood NRG offered employment to all of the staff but not all of them accepted, because they didn't fully understand what the acquisition meant.

The timeline from that point on was quick. Fernwood NRG did some renovations on the space to outfit it as a hair salon. Then, they set the lease rate, renamed and reopened the business, about a block away at Studio 1313, three weeks later.

With the management contract in place, the previous owner continued operating her business, with little oversight required, with little oversight, because they knew that she was capable of running a successful hair salon.

The word got out about the new ownership, and they hired more staff. Customers started coming, and Studio 1313 Hair Design was able to continue to operate in community, increase its revenue and maintain employment opportunities.

MOTIVATION BEHIND THE ACQUISITION

Neither party was actively seeking out an acquisition. Both responded to the opportunity as it presented itself.

From the Seller's Perspective:

- Preserving her business in the community without having to take on the risk associated with signing a new lease.
- Maintaining employment opportunities for her staff.
- Maintaining employment for herself.

From the Buyer's Perspective:

- Preserving the business in the community.
- Creating an additional revenue stream that the organization could use to fund its community programming.
- Filling up a commercial space long-term, which would reduce the risk in their building.
- Increasing Studio 1313 Hair Design's positive social and environmental impacts.

PREPARATION PROCESS

The **preparation process was quite informal** and minimal in this case. In part because of the short timeline, and because Fernwood NRG's ED and the previous owner already had a friendly, trusting relationship.

The previous owner **prepared her books** and shared them with Fernwood NRG's ED.

The **due diligence process was minimal**. The previous owner was a sole proprietor, who had never planned to sell her business. She didn't have prepared financial statements, because she didn't need them. Theoretically there was a lot of risk, but Fernwood NRG's ED was **focused on the revenue and cost structure**, which the previous owner was able to explain to him.

The ED modelled the financials of the business based on past revenue and a few **assumptions**: he assumed Fernwood NRG would be able to manage costs slightly more tightly, increase revenue, and increase prices in the new space.

Based on those assumptions and some revenue growth, the ED was able to **model the financials** of the business and see the underlying profitability.

The ED and previous owner negotiated wages and benefits for her staff and a **management contract** for herself, which was incentivized based on growth.

No legal, accounting or consulting work was required. **The deal was sealed with a handshake between the two parties.**



DEAL STRUCTURE

- The deal was structured as an **asset purchase**, which means Fernwood NRG bought the inventory and chattels of the business rather than the shares, brand or goodwill of the company.
- Fernwood NRG is a charity and is the sole shareholder in a **subsidiary company**, which they used to acquire and hold the business.
- Fernwood NRG now has **full ownership** of the business.
- The previous owner signed a 2 year **management contract**, which required her to continue running all the activity in the space. This also ensured that the goodwill of the business that was attached to the previous owner carried over in the transition.

FINANCING

- Cost of acquisition:
 - \$5,000 to purchase the business assets.
 - A generous management contract.
 - Put \$20,000-\$30,000 into the business over the next 1.5 years to outfit the space.
- The acquisition was self financed.

KEY TAKEAWAYS

CHALLENGES

For both parties:

- Some of the **staff left during the transition**, which made the process more difficult, because much of the goodwill and value of a hair salon lies with its staff.

For the buyer:

- It was difficult for the Executive Director, who spearheaded the acquisition, to **convince his staff and board members** to buy into the idea that the acquisition would be good for the organization as a whole.

For the seller:

- The seller only had one challenge to report: when the business was acquired by Fernwood NRG, she felt that the staff member who she was told to report to was **micromanaging** her. She found this frustrating because the Fernwood NRG staff member didn't have the sector-specific knowledge that seller did.
 - This is a commonly cited challenge in acquisitions. It's often **difficult for the previous owner to adjust to becoming an employee**, who can no longer make executive decisions with no oversight, after the acquisition.
- To solve the issue, the seller went to the ED and asked if that staff member could step out. The problem was addressed quickly. After that, she reported directly to the ED, and everything was fine.

LESSONED LEARNED AND ADVICE

- Keeping the previous owner on with a **management contract** was key to a successful transition. It ensured that the goodwill, reputation, and sector specific knowledge that were attached to the owner stayed with the business as it transitioned ownership.
- From the perspective of the seller, the fact that Fernwood NRG trusted her abilities and gave her the **freedom to run the business with little oversight** was critical. It enabled her to successfully get the business to the point where it could run itself under Fernwood NRG's ownership before she retired.
- The previous owner emphasized the importance of spending time **searching for the right manager**, who will bring the same the same passion to the position as the founder, to take over after the previous owner exits the business.
- Fernwood NRG's ED doesn't recommend purchasing a business and running it off the side of your desk, but if the purchasing organization has staff with the **capacity and capabilities** required to run a business, an acquisition can generate income to help support the nonprofit.
- The previous owner called the acquisition the **"perfect exit strategy,"** because it preserves the business and employment opportunities in the community. However, she also stated that she only recommends it if the owner is planning on exiting the business within a couple of years. The power dynamics between the seller and the purchasing organization become significantly more complicated if the previous owner stays on for a prolonged period of time after the acquisition.

OUTCOMES

FINANCIAL RESULTS

- Sales dropped in the first few months after the acquisition, because the business lost some of its staff.
- Once Fernwood NRG hired more stylists and began promoting the business, sales started rising steadily.
- Revenue grew substantially in the first few years, from around \$12,000/month in 2014 to \$30,000/month in 2018.
- Profit margins are around 15%, meaning the business contributes around \$4,500 per month to the charity.
- In addition to that profit, the hair salon pays rent to the charity (because Fernwood NRG owns the building).
- The hair salon has generated new clients, because the community knows that it is now owned by a nonprofit. People from the neighbourhood like the idea that their money goes back into the community when they got their hair done at Studio 1313.



SOCIAL AND ENVIRONMENTAL IMPACTS

- The acquisition meant that the previous owner didn't have to lay off her staff. It gave her the opportunity to preserve her business and her staff's jobs and continue to serve the community in a new space.
- Fernwood NRG raised the commission for stylists when they acquired the business.
- After the acquisition, Studio 1313 became a Zero Waste business. It now offers a line of eco friendly products and non-ammonia colour treatments.
- The stylists also participate in a youth training program. They teach students from a nearby high school how to cut hair.
- Finally, the stylists help out grads who come from low income households by giving them a nice hairdo for their graduation at a reduced rate.