Getting started

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Learning objectives

In this chapter you will learn about:

1 Setting up a new business

2 Sources of finance for a new business

3 Preparing a business plan

Reasons for starting a new business

- For some people, being an employee does not offer enough **challenge**, but making a successful new business does.
- Many people have a strong desire to make their **own decisions**.
- Setting up a business offers the chance of earning **profits**.
- Some people feel more **secure** in controlling their own business.
- Sometimes people are pushed into setting up a business by **circumstances**, e.g. a redundant worker with a lump sum of money may start a new business as a way of self-employment.
- Some people can come up with **new ideas** or **inventions** that become the basis for a business.

Challenges facing new businesses

- It can take a long time and a lot of money to get the product **ready for sale** on the market.
- It can be difficult to obtain **start-up finance**.
- Many promising new businesses fail because of **cash flow** problems.
- Getting the product **onto retailers' shelves** is essential to success, but this can be difficult for a start-up business.
- New businesses usually have to **compete** with long-established businesses.
- Finding the right **staff** and training them can be difficult.
- Finding suitable **premises** at a reasonable rent can be difficult.
- **Legal requirements**, e.g. getting a licence, getting planning permission, registering for tax or forming a limited company, can be complicated.

Ownership structures

- Sole trader
- Partnership
- Private limited company
- Co-operative
- Public limited company (PLC)

Top Tips!

- You should be able to discuss the reasons why people start their own business and also to explain the challenges faced by new firms.
- Make sure that you can compare the different types of ownership structures in terms of their suitability for a new business.

Sources of finance for new businesses

Type of finance	Uses
Long term (5+ years)	
Owner's capital (equity)	Purchase of fixed assets
Loans/debentures	
Grants	
Medium term (1–5 years)	
Term loan	Purchase of vehicles, equipment
Leasing	
Hire purchase	
Short term (0–1 year)	
Trade credit	Paying creditors
Overdraft	Purchase of stock
Accrued expenses	

Factors to consider when choosing a source of finance

Cost

The firm should look for a source of finance which is **low cost.**

Example: As long-term sources of finance, equity finance and grant aid have no cost compared to a bank loan (which will have a commercial interest rate).

Control

Some forms of finance may result in some **loss of control** over the business or its assets.

Example: A medium-term loan used to purchase a computer system gives the firm ownership of the asset. In contrast, hire purchase will give ownership of the asset only when the final payment is made.

Amount

If very **large amounts** of money are required, it makes sense to use **long-term** finance to spread out the repayment period. If smaller amounts are needed, short-term finance can be used.

Example: A long-term loan of €400,000 for a building extension can be repaid over ten years. A wages bill of €2,000 can be financed in the short-term using a bank overdraft.

Purpose

The use of the finance should be matched with **suitable sources** of finance, e.g. fixed assets with long-term finance or paying creditors matched with trade credit.

Collateral

If a firm cannot/does not wish to give collateral against a source of finance, it will have to use sources not requiring collateral.

Example: Banks often require fixed assets of the firm to be used as collateral or security for a loan.

Top Tip!

You need to be able to differentiate between long-, medium- and short-term sources of finance and match each source with its purpose.

Managing working capital

Working capital refers to the assets and finance available to be used in the day-to-day running of the business.

Point to note

Working capital = Current assets – Current liabilities

Methods of managing working capital

- Cash flow forecasting
- Credit control
- Liquidity ratios
- Stock control

Methods of production

- **Job production:** Each item is produced individually for a specific customer and to that customer's specific requirements, e.g. a one-off trophy, a made-to-measure wedding dress, a ship or a landscape gardening service.
- **Batch production:** Producing a quantity of a product at one time and then switching production to a different product, e.g. clothing and footwear, which are produced in batches of different sizes, styles, materials and colours.
- **Mass production:** Producing very large quantities of identical products by a continuous

automated process, e.g. Biros, razors, computer chips, cigarettes and cars.

Top Tip!

As well as being able to describe each method of production, you should also be able to illustrate them using examples.

Business plan

Just like any other business, a new business must have a business plan. The business plan sets out the firm's objectives and the methods and resources it will use to achieve these objectives.

Elements of a business plan

- Nature of the business
- Ownership
- Management
- Marketing plan
- Production plan
- Financial plan

Nature of the business

This involves a description of the **product** or **service** to be produced.

Ownership

This is an outline of who the owners will be and what the ownership **structure** will be. The **qualifications, experience** and achievements of the owners will be described.

Management

This outlines how the business will be organised and who the key management personnel will be, including their experience and qualifications.

Marketing plan

This sets out details of the marketing mix that will be used by the firm in selling the product.

Production plan

This provides details of how and where production will take place, identifying buildings and equipment that will be used. It will also indicate the production process that will be used, materials and workforce required.

Financial plan

This will detail the finance required by the business and how it will be sourced. It will include cash flow forecasts and projected trading and profit and loss accounts for the first two trading years.

Top Tip!

Know the main headings for a business plan. You should be able to draw up a business plan using information provided to you.

Exam question

1.Read the information supplied and answer the question that follows.

Michael Kelly is 29 years old and is a graduate with an engineering degree. He has been working in the area of research and development in a large transnational company since graduation. He has a desire to work for himself and feels that the time is right to form his own business in his home town producing electronic parts for domestic appliances. He has asked you to help him in writing his business plan.

(a) Explain the importance of a business plan. *(20 marks)*

(b) Draft a business plan for Michael Kelly's venture under five main headings. State relevant assumptions where necessary. *(2002, 40 marks)*

Sample answer

(a)

A business plan is important for the following reasons:

- It gives a clear focus to management and all other employees on achieving the objectives of the firm.
- It provides objectives against which the actual performance of the firm can be measured.
- In drawing up the plan, the promoters can evaluate whether the business is a viable one.
- The plan is needed to convince prospective investors that the firm is likely to be a success.
- A business plan is necessary to show to banks when seeking loan finance from them.
- The government will want to see a business plan when considering giving grants to the business.
- It is needed to provide information on the firm to other interested parties, such as employees, trade unions and suppliers.

(b)

BUSINESS PLAN

MK Engineering Ltd, Domo Industrial Estate, Nenagh, Co. Tipperary

The business

MK Engineering manufactures electronic parts for supply to manufacturers of domestic appliances worldwide. The firm is set to take advantage of the strong growth in the world market for electrical appliances. The firm has been registered as a private limited company.

Ownership and management team

- **Shareholders:** Michael Kelly, James Wilson, Patrick McElroy
- **Managing director:** Michael Kelly, graduate in engineering, taking responsibility for product development
- **Production manager:** Emily O'Loughlin, Bachelor of Production Engineering
- **Marketing director:** James Wilson, MBA (Marketing)
- **Finance manager:** Gordon Allen, ACCA

Production plan

Production based at Nenagh factory with initial staff of 30 operatives. The range of products will be produced on a batch production basis. Some products will be outsourced from the UK until the plant reaches full production. There is a supply of suitably qualified staff available in the region around the factory. Initially the plant will operate two production shifts a day with the option of adding a third shift. There is adequate land to extend the factory in the medium-term.

Marketing plan

The firm has already secured a five-year contract to supply parts to German multinational manufacturer Kuhne, for which Michael Kelly previously worked. The firm intends to develop markets with major appliance manufacturers in Europe, East Asia and the United States. Product innovation is seen as the firm's unique selling point in competing in the marketplace. The firm's pricing will be competitive with the other manufacturers, but we will have an advantage in superior quality and reliable performance. Our main method in promoting our products will be in specialised trade exhibitions around the world.

Financial plan

Finance required	*Source*
Long-term capital: €5 million	€1.5 million share capital issued
	€1.5 million government grants
	€2 million 20-year bank loan
Medium-term capital: €250,000	Vehicles hire purchase: €100,000
	Equipment leasing: €150,000
Short-term capital: €100,000	Bank overdraft: €100,000

Detailed cash flow forecasts and projected final accounts for the first three years are attached. Projected profits are year one €200,000; year two €300,000; year three €500,000.

Marking scheme

(a)

- Three points: 1 x 7 marks *(7 = 3 + 4)*; 1 x 7 marks *(7 = 3 + 4)*; 1 x 6 marks *(6 = 3 + 3)*
  - 3 marks for stating point
  - 4/3 marks for development/example/illustration

(b)

- Five headings/sections: 5 x 8 marks *(8 = 4 + 4)*
  - 4 marks for heading
  - 4 marks for details and expansion

Questions

Higher Level long questions

1 **(i)** Explain the term 'business plan'.

(ii) Evaluate the importance of a business plan to an innovative new technology business. *(2012, 20 marks)*

2 Discuss two possible challenges associated with starting a new business. *(2011, 10 marks)*

3 Marie Nolan is the owner of Marie's Pizzas, a successful pizza restaurant with a home-delivery service. Demand for takeaways has increased, as more people are eating at home due to the economic downturn. Marie is planning to expand her business through franchising, and her accountant recommends that a business plan should be prepared before going ahead.

(a) Evaluate franchising (benefits and risks) as a method of expansion for the pizza business. *(2010, 20 marks)*

(b) Outline two benefits to Marie's Pizzas of preparing a business plan. *(2010, 10 marks)*