Contents

Preface

REASONS AND GOALS FOR THIS SOLUTION

Since 1994, Credit Union Microfinance Innovation (CUMI) has been one of the focal points of ACCU's services to members and countries where poverty is widespread. The conferences and training programs carried out in the past years were to heightened awareness on the need for credit unions to focus on the "have less" market segment. The poor market segment, if tapped is a source of enormous growth for credit unions.

The innovations have improved the quality of service to "have less" by incorporating wealth building strategy (savings) rather than creating dependency on loan, continuous education, doorstep service, self-help group pressure, and graduation to the regular membership of the credit union. ACCU recognizes that access to affordable financial services; savings and credit; and education would not ensure the sustainability of the entrepreneurial poor. ACCU equally recognizes the importance of "Access to Markets" as an important component of CUMI.

With the increasing spread of the effects of globalization, small entrepreneurs supported by credit unions are facing difficulties in improving their businesses. Entrepreneurs these days are faced with increasing challenge of the brought about by multinational companies penetrating into the more remote corners of the earth and exploring traditional plants, seeds and other natural products for product development and commercial gain.

The Business Development Center (BDC) for the National Federation of Credit Unions is seen to be playing a crucial role in developing the capacity and access to good market services, such as credit schemes, transport facilities, market information, business development services, insurance mechanisms, accreditation, quality assurance and trade facilitation. BDC provides assistance to credit unions, members and micro entrepreneurs enabling them to carry out management and marketing support to current and prospective small business owners who maybe are members or potential members of the credit union. BDC offers one-stop assistance to individuals and small businesses by providing a wide variety of information and guidance in central and easily accessible branch locations. The program is a cooperative effort of the primary credit unions and district leagues, as applicable in some countries. The BDC is an integral component of Entrepreneurial Development's network of training and counseling services.

This Toolkit will help the National Federation to take the first step in establishing its BDC. The suggestions of our members to improve this manual is very much welcome.

ACKNOWLEDGMENTS

We would first like to thank the Agriterra, the Netherlands for providing us the opportunity to implement the project on Women Empowerment through Microfinance. The Business Development Center Toolkit is the output of this project. ACCU appreciation also goes to the Credit Union League of Thailand for allowing us to use its Women Business Development Center as an action research. We also thank our members particularly those implementing CUMI. This manual was developed based on the need arising from the CUMI program.

Finally, we want to thank all ACCU’s member organizations for their support and cooperation. They provided us with valuable learning experience and continually challenged us to develop innovative programs that delivered results.

ACCU

ASSOCIATION
OF ASIAN CONFEDERATION
OF CREDIT UNIONS

INTRODUCTION

Roots of Learning: Over 150 Years

Microfinance is not new for credit unions who were first organized in the mid of 1800s in Europe. They were born out of miserable economic conditions and the realization that disadvantaged people would have to take action themselves through the establishment of self-sustaining and self-help financial services. Credit unions grew and paved their way in Asian countries, the home of the poorest people in the world and should thrive and prove their relevance in helping poor people help themselves. The outreach of credit unions in the poor market segment is insignificant compared with the large number of potential poor members and ACCU is constantly examining whether Asian credit unions are adhering to their original mission to improve people's well-being through the provision of affordable financial services specially those who do not have access to them.

In 1994, ACCU and its members defined the need for credit unions to refocus its services on the poor market segment. The product introduced by ACCU in 1999 named Credit Union Microfinance Innovation (CUMI) is a sustainable provision of financial services to the poor market segment. Wealth building savings, affordable terms on loans, education on thrift, entrepreneurship, and credit union involvement in the financial lives of members, focused on their long-term well-being are the advantages CUMI offers to the low-income poor. CUMI aims to integrate low-income members into the mainstream of society.

CUMI has considerably increased credit unions' responsiveness and care of the financial needs of people belonging to the poor market segment. Seven credit union movements namely Bangladesh, Cambodia, Indonesia, Nepal, the Philippines, Sri Lanka and Vietnam have successfully adopted CUMI and ACCU has transferred the technology to our member organizations in both training and practice. The national federation acquires the appropriate skills and operational framework, making it possible for adoption as another service offering to their member credit unions.

Member organizations in countries where the incidence of both rural and urban poverty are found, consider the program a priority and tool in alleviating poverty. More than 50,000 low-income poor have gained access to affordable financial services from 326 credit unions that ACCU is supporting in partnership with member organizations and development partners, such as Credit Union Foundation Australia, Cordaid and Agriterra from the Netherlands. In addition to the direct impact in the pilot projects, our national federations have replicated the CUMI and it has become part of their regular program.

The four batches of professional Training on Microfinance and Microenterprise Development resulted in more than 120 CUMI practitioners who are now directly involved in the implementation of the CUMI methodology in our member organizations. Trainers and practitioners were also trained, increasing the human resources available in the movement advocating CUMI. CUMI is an effective means of alleviating poverty and in addition to the direct impact of raising incomes and encouraging poor households to enter the market economy; the scheme serves as an entry point for comprehensive community and human development. Despite significant achievements in reaching the low-income poor, poverty is still one of the most serious problems confronting many developing countries in Asia. Asia is home for more than 800 million poor people in the world and ACCU is continuously motivating and increasing the capacity of our partner federations, to focus more on sustainable strategies to reach more low-income poor.

ABOUT THE BUSINESS DEVELOPMENT CENTER (BDC)

The Missing Link: Business Support Services

ACCU is in aiming for improvement of the CUMI and the May 2-6, 2004 Regional Women Networking Meeting on the theme "Tools for Trade" held in Bangkok, served as the venue for discussions on the sustainable development of CUMI. The meeting reviewed the need for appropriate development strategies and policies to stimulate empowerment of the low-income poor. Twenty-nine women discussed issues related to the sustainability of microfinance programs in credit unions with the resulting sustainability of its low-income members. Dialogue reached the next stage of finding ways to ensure the viability of members' businesses to enable their financial independence.

The Business Development Center (BDC) initiated by the Credit Union League of Thailand (CULT) serves as an action research initiative for Asia. Gaining access to market; maximizing the use of local materials for global market; obtaining market information; taking advantage of forward and backward linkages; producing trendy local products are only some of the benefits the center delivers to the entrepreneurial poor. Access to affordable financial services is not enough to break the poverty cycle while economic independence of the low-income poor lies on the viability of the project they are engaged in.

The Regional meeting increased the awareness of the member organizations on the role of the BDC and the meeting recommended the development of BDC structure for the guidance of member organizations.

BDC is a support service unit of the apex organization of credit unions that serves the small business community and thriving entrepreneurs particularly within the sphere of the microfinance groups.

The BDC provides assistance to credit unions, members and micro entrepreneurs enabling them to carry out management and marketing support to current and prospective small business owners who maybe are members or potential members of the credit union. BDC offers one-stop assistance to individuals and small businesses by providing a wide variety of information and guidance in central and easily accessible branch locations. The program is a cooperative effort of the primary credit unions and district leagues, as applicable in some countries. The BDC is an integral component of Entrepreneurial Development's network of training and counseling services.

BDC's assistance is tailored to the local community and the needs of individual members. The center develops services in cooperation with credit unions nationwide and in coordination with other available resources. The center, in its full-scale operation has a director, staff members, volunteers and part-time personnel. Qualified individuals recruited from professional and trade associations, academia, chambers of commerce and Development Educators are among those who can donate their services. BDC also use paid consultants, consulting engineers and testing laboratories from the private sector to help members who need specialized expertise.

Building Leadership

BDC assumed a leadership role in defining directions for advancing the development of microenterprise in credit unions. The real task, however, is to foster leadership by enabling credit unions assist members and potential members who strive to create their own economic destinies. The results of this effort would be evident in the diverse microenterprises around the credit union movement that signify a qualitative improvement in the lives of families and individuals and that strengthen, grow and stabilize the country's economy. As these credit union members prosper, so, in turn, does country's economy.

The Need

Many people choose self-employment because it is the only way they can obtain work that is personally rewarding, provides a living wage to support their family, and can be worked around their personal situation. Self-employment can provide quality jobs for people with situations that are not easily accommodated in the traditional workforce, e.g. poor people with limited education or work experience, people with disabilities, single parents, people with health restrictions, etc. Without the option of self-employment, many individuals would be limited to dead-end, minimum wage jobs, despite strong ambition and marketable skills. Self-employment through microenterprise can be a wonderful opportunity for anyone to try new ideas or pursue a dream. More than 800 million poor people are living in Asia and for this market, the credit union services is very relevant. Poor people only need an opportunity, not grant not welfare.

Credit unions have adopted microfinance as a product that provides access to affordable financial services to potential members living in poverty. The business loans made to the have less enable them to carry out business enterprise capable of generating self-employment. Most of the enterprises currently undertaken by the microfinance members are traditional. Poverty reduction through enterprises forms a key part of Microfinance program. The Credit Union Microfinance Innovation (CUMI) promotes and supports disadvantaged, marginalized, or poor producers; whether they are independent, family businesses or grouped in associations. CUMI aims to enable them to move from a position of vulnerability to one of security and from material poverty to income and ownership.

At present, CUMI offers savings; credit and training opportunities to its members, however, the credit unions have yet to support entrepreneurs in developing their enterprise management and business skills. In the absence of this support, poor people are again living in subsistence economy. A sustainable means of empowering the poor is by ensuring that the program provides the four components:

- Mobilization
- Financial Services
- Continuous Training
- Support Services –Market linkage and information, product innovation, enterprise consulting services etc.

In the absence of a support mechanism, CUMI has a limited means of exploiting the prospects on enterprise growth. The limitations that confront the CUMI progam are:

- Slow phase of economic growth of members as majority are engaged in non-innovative business activities such as selling cooked foods, sewing, retailing, fish vending and others.

- Limited opportunity to develop entrepreneurial skills of members

- Inability of the credit union to sustain the provision of capital because of limited investments opportunities available for its members

- Lack of access to technology-the entrepreneurs do not have information and capital to purchase for labor saving devices, machineries and equipment that could have increased the production capacity

- Lack of knowledge and skills–at the enterprise level, what hampers the entrepreneurs are their lack of business knowledge and skills.

- Limited access to information – entrepreneurs do not have knowledge on market information and the opportunities it offers. Due to this limitation, the entrepreneurs are comfortable to usual business activities targeting the local market.

- Some members engaged in innovative kind of business are faced with the problem of marketing

The BDC could help to overcome the above constraints and it will enable the entrepreneurs to take advantage of the enterprise prospects in the local and international market. BDC provides business development services to small entrepreneurs enabling them to hurdle the bottlenecks and constraints.

PURPOSE

BDC's goal is education. People with the vision, discipline and drive to pursue self-employment often lack business basics. Even experienced business owners may struggle to makes ends meet because they do not excel in certain areas of business management. Because small business owners are required to be a "jack-of-all-trades," it is important that resources are available to help them learn necessary skills. The BDC's counseling, workshops, and classroom training provides a foundation for their success.

Through education, BDC helps people overcome barriers. People with limited financial resources usually face even greater initial barriers to business start-up and expansion than others do because they lack collateral for loans, they may have poor credit histories, and they may be strapped by cash flow problems. Barriers like these do not need to prevent people from running a successful business. We can show people how to get the resources and assistance they need. At the credit union level, BDC helps to create demand for loans. Credit unions generally grant loans for productive purpose but in the absence of proper investment analysis, the loan recovery is at risk. BDC is a tool to support the lending activities of the credit union and the national federation.

The BDC provides an integrated set of choices on business development services leading to members; successful enterprise:

- Training which empowers the entrepreneurs to manage their businesses by giving them the business knowledge and skills required to implement activities in an effective fashion;

- Technical services, the most sought after of which is Product Development and Design Consultancy;

- Business consultancy that covers all the management areas of a business e.g. business planning; financial management, production operations management, marketing management and organizational development; technology and,

- Trade facilitation that includes sponsorship to trade fairs, provision of market windows, organization of selling missions, producer-buyer matching and direct marketing

- The BDC also make special efforts to reach minority members of socially and economically disadvantaged groups, women and the disabled. Assistance is provided to both current or potential small business owners in the credit union.

PARTNERSHIPS

BDC's scope is quite huge. Partnerships with different stakeholders and interest groups are established. BDC can outsource the expertise from these partners:

1. Government agencies: including the Department/Ministry of Trade and Industry; Department/Ministry of Labor and Employment; Department/Ministry of Agriculture and Cooperatives; Cooperative Department and other agencies promoting and supporting microenterprises

2. Non-profit organizations: promoting and supporting microenterprises

3. Municipalities or Provincial Government: the local government units also support and promote entrepreneurship.

4. Other microenterprise service providers

5. In addition, recognize the important contributions of volunteers from numerous private businesses and individuals.

FUNDING OF THE BDC

The national federation provides operating capital for the BDC in support of its central finance facility. The BDC stimulates the business of the primary credit unions by creating demand for business loans. The small and microenterprise business engaged in by the members will have greater chances of success through the opportunities offered by the center e.g. business skills, technology, market linkages and information provided for the BDC through the primary credit unions.

Based on CULT's case study, the following income sources are at hand:

- Consulting services- since BDC is creating business opportunities to credit unions, the center charges fees on the services it provides to members.

- Sales of products-the center earns profit to cover the cost of its operation from the trade deal closed within or outside the credit union sphere. In addition, the center can also be transformed into credit union souvenir center. The center can develop products using home-grown materials for credit union marketing or give away e.g. Annual General Meetings; Happy Birthday Program; and other marketing materials on credit union financial services

- Training Fees-the center can also charge fees in conducting training programs at the credit union level

- Sales of Publications such as Books on Starting a Business; Toolkit for Business; CD Rom; Video on Business; etc.

MANAGEMENT STRUCTURE

BDC is a structure within the national federation. The following is the functional management structure of the BDC. The BDC operates as a regular department of the national federation. The BDC Department head reports to the CEO or General Manager and the General Manager reports to the Board.

Figure 1: Management Structure of the National Federation

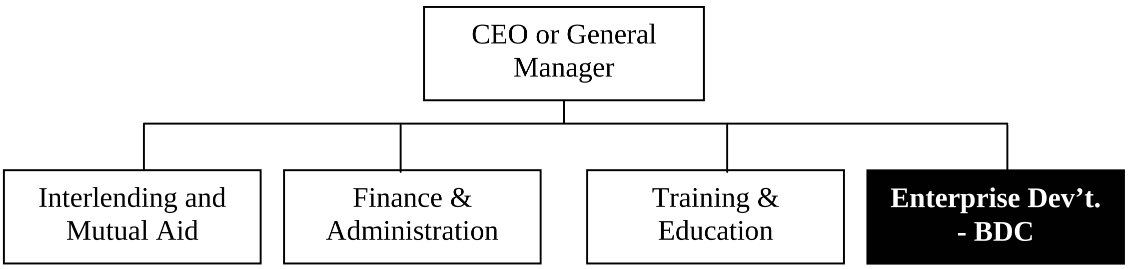
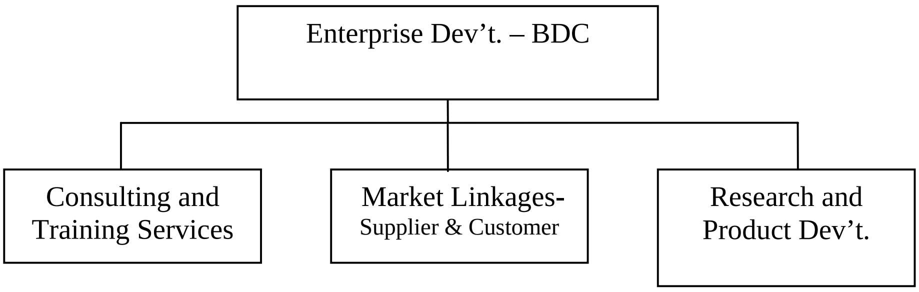


Figure 2: Functional Structure of the Business Development Center



Key Positions Required:

- Head of the Enterprise Development Department-in charge of the overall management of the department
- Training and Consulting Specialist-develop training curriculum, consulting services, tool guides, and carry out training programs
- Marketing Specialist-organize trade fairs, maintain market linkages, develop partnerships, identify buyers and suppliers, maintain the Cooperative Product Display Center

- Research and Product Development Specialist –maintain and analyze data base of market information, publish research carried out, identify market potential

The Service Map provides guidance on the tasks assigned to the staff of the Business Development Center. The roles and responsibilities of the department are as follows:

1. Provide consulting services on enterprise development

2. Develop tool guides on enterprise development for start-up, expansion and commercialization stage of enterprise

3. Facilitate the entrepreneurs from the credit union in their participation to trade fairs

4. Facilitate market linkages and networking from and among the credit union members and suppliers/customers

5. Develop training modules on enterprise development and management

6. Carry out national and in-house training programs on enterprise development and management

7. Maintain data base on market information such as demographics, industry, suppliers and manufacturers and entrepreneur statistics

8. Publish Tool Guide on Business Planning and Management

9. Carry out research on new products, technology and legal framework for business expansion and commercialization

10. Establish a Cooperative Product Display Center to market the products of the entrepreneurs

Detailed Job Description of the staff of the Business Development Center can be designed based on the above tasks. The Job Description should be reviewed on an annual basis.

BDC'S SERVICE MAP

Assistance from BDC is available to any credit union implementing a microfinance program. Significant number of members of this credit union is interested in beginning a small business for the first time or improving or expanding an existing small business. Various technical skills are required to operate the BDC. The federation can outsource such services through partnership with government agencies promoting SMEs. The following table shows the services that can be provided and facilitated by the BDC:

	Enterprise Start-up	**Enterprise Expansion**	**Enterprise Commercialization**
Consulting Service	• Feasibility Study preparation • Small Business Tool Guide • Business Planning • Product design • Product Pricing • Market Linkages	• Export Assistance • Display Center • Trade Fair participation	• Intellectual property-copyrights, patents, trademarks •
Training	• Business Management • Accounting and Budgeting • Business Planning • Cash Flow Management • Customer Relations • Legal Issues • Marketing and Sales • Starting a business	• Business negotiation • Coaching on Marketing Plan Preparation • Direct marketing of products • Product Packaging	• Business training • Business Technology • Computer and Internet Training
BizFacts-Research and Product Dev't.	• Business Plan outline • Home business basics • Licenses, Patents and Taxes	• Demographics and statistics • Industry at a glance • Suppliers and Manufacturers • Industry benchmarking	• Data bank of market information
Market Linkages	• Business Plan samples • Business Ideas	• Industry Profiles • Market Information Services • Small Business Directory-suppliers and buyers • Product Catalogue • Promotion of forward and Backward linkage	• E-commerce

Business Plan for the BDC should be prepared based on the service map. The format of the BDC's Business Plan is in Appendix B of this manual.

Consulting Services

The BDC provides, for a minimum fee, one-to-one professional consulting for credit unions engaged in microfinance. BDC provides advice on the project evaluation and counseling provided by the credit union to entrepreneurs. Loan applications inevitably require formal business plans, so BDC trains staff of the credit union on counseling that frequently begins with creation of the plan. The recommendations provided by the BDC to the credit union serves as guide in evaluating the validity of the business concept and the readiness of the member to undertake self-employment. This evaluation allows the credit union to make the best recommendations to the member regarding next steps and continued training.

Help available includes:

- advice on operating challenges in existing businesses
- challenges in existing businesses
- review of business plans and strategies
- guidance in new business start-ups
- advice on purchases of existing businesses
- preparation of loan requests
- financial analysis and budget development

The center's Business Tools, offers guidance in handling new business operations and finances. The BDC neither lends money nor administers grants. However, business consultants, outsourced from different credit unions or government agencies, can assist small business owners in meeting their operating challenges. Because the National federation's BDC has a nationwide scope, consulting needs can be met using the credit union network channel.

Training Services

Training on a variety of business topics is offered. The BDC training courses range from introductory programs for those planning to start a business to advanced seminars aimed at the experienced entrepreneur. Some topics offered by BDC:

- marketing
- business planning
- government contracting
- financing
- starting a business

The topics and scheduling vary between regions. However, the training schedule can also be accessed on the web. BDC will ensure that the training it offers is accessible. Training can be arranged on-line or locally. A schedule of upcoming seminars is mailed to credit unions or posted on the website.

Research Services

The BDC research services offer entrepreneurs specific information to answer business questions. BDC's Research Center, located at the national federation office, contains various research materials to help in the business formation process. Some of the resources include sample business plans, industry start-up guides, books on varying business topics, Internet access, and CD-ROM databases.

The BDC Research Center is the place to come for research or information. The materials can help with such things as preparing:

- personnel policy manuals
- exporting strategies
- loan proposals
- business plans
- marketing plans
- cash flow budgets, complete with industry comparisons

The Research Center publishes these resources and made available for sale to its member credit union to cover the cost of publication. The center ensures that the publications are consistently reviewed and updated according the changing market environment.

In addition to the Research Center's on-site resources, web-based resources are accessible through the national federation's website. One valuable information source is the BizFacts which provides access to information on:

- how to start a business
- how to prepare a business plan
- industry profiles with a description, capital requirement, business environment
- business proposals according to different ranges of capital available
- Market information

The following business fact sheets (BizFacts) on starting and operating a small business will be made available by BDC:

BDC Services

101. BDC Brochure – About BDC Services
102. Business Development Center Training Program - Training calendar for the credit unions
103. BDC's Resource Centers - A list of Resource Centers for Small and Medium Enterprises such as Department of Trade and Industry, Technological and Resource Centers, or any institutions GOs/NGOs
104. Industry Profile
105. Market Research – information on market and suppliers

Tools for Starting a Business

201. The Loan Proposal - Suggested Contents
202. Thinking About Going into Business? - Answers to questions about starting and operating a business Economic Injury Disaster Loans For Small Businesses
203. Checklist for Starting a Business - Overview of major steps critical to planning and starting a business
205. Starting a Business and Obtaining Financing - Answers to nine commonly asked questions
206. Business Plan Outline - Suggested format and content of a business plan
207. License, Permit and Tax Requirements
208. Steps to Success - Nine Steps to Success
209. Prototype Feasibility Study on Different Enterprises found to have potential for growth and success

Area of Training Programs and Consultancy

- ### Business Start Up

301. Planning Considerations for Starting a Small Business, the Ingredient for Success
302. How to Price Your Products and Services - Pricing your products and services
303. Business Feasibility: Overview - Key elements to consider about your prospective business
304. Business Feasibility: Making the Decision - Evaluate the feasibility of your business idea
305. Reflections in the Mirror-An Entrepreneur's Story - A true account of a successful entrepreneur
306. Marketing Ingenuity and Invention - Identifying the strengths and weaknesses of a new products at an early stage saves time and money
307. Do-It-Yourself Research for Business Planning - Guidelines for finding information sources and conducting a business research project
308. Choosing the Business Legal Structure - Helpful comments

- ### Recordkeeping and Managing Business Finance

309. Improving Decision Making with Simple Break-Even Analysis - How to use break-even analysis
310. Recordkeeping in Small Business - Information on recordkeeping for business
311. Audit Checklist for the Growing Business - Essentials for conducting a comprehensive search for existing or potential problems in business
312. Understanding Financial Statements: What Do They Say About Your Business - A guide to understanding business financial statements

313. Managing Cash Flow - Learning to deal with and forecast your most critical asset
314. Patents, Trademarks and Copyrights

- ***Marketing and Advertising***

315. Market Designs for Service Business - Includes market research and market niche information
316. BDC Research Center Marketing Resources - Marketing and advertising titles available
317. Is There a Market for My Product or Service? - Researching your market
318. Signs...And the Small Business - How to select a sign for your business
319. Publicity Do's and Do not's - List of do's and do not's for publicity
320. Publicity Techniques for Growing Businesses - Publicity-what it is and how to get it
321. Why your Business must make use of the Internet - Why it's a good idea and some suggestions
322. Marketing Do's and Don'ts - Back to the basics of advertising your products and services

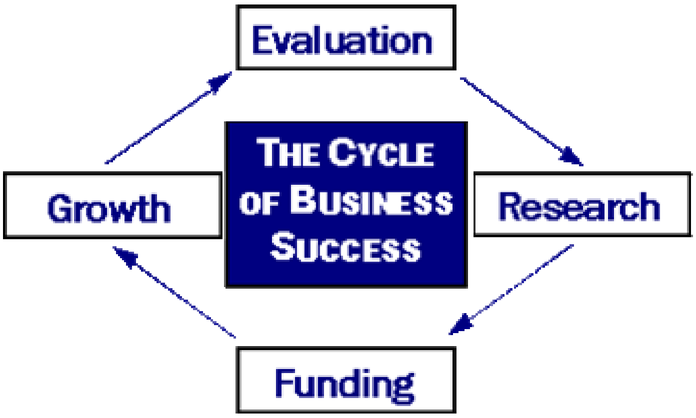
- ***International Trade***

301. Frequently Asked Questions and Answers on Exporting
302. Where to Find Exporting Assistance - Sources of export information and assistance to small business
303. Preparing An Export Price Quotation - Outline for developing an export price quotation
304. How to Develop an International Business Plan - Outline for developing an international business plan
305. Export Sales Contract - Samples and information related to export contracts
306. Proforma Invoice and Price Quotations Used with Foreign Companies - Sample proforma statement price quotation information and guidelines
307. Export Potential Checklist - Checklist to help determine a company's export readiness
308. Making the Export Decision - Advantages and disadvantages of exporting
309. Useful Books on Exporting - A list of useful resources for export trading/management companies
310. Growing Profits for Small Business Through Global Expansion - How a manufacturing firm expanded its markets by exporting

Appendix A

Business Development Center's
TOOLKIT

TOOLKIT 1
STEPS TO START-UP



EVALUATION

Defining Your Business Idea

It is important to think through the details of your business idea and get it down on paper. Key questions to answer:

- My business idea is ________________
- My proposed business name is ______________
- My products/services, in order of importance, will be ___________
- My average customer will be (describe in terms of age, gender, education level, income level, etc.) ___________
- My business will cover this geographic market area ________________
- My major competitors will be _________________
- Customers will buy from me instead of from competitors because ___________
- Education and skills I will need are _______________
- Other resources I will need to line up are ____________

Once you define your idea, it is time to set some goals.

Setting Goals

Determining goals is a difficult and sometimes frustrating experience. Yet, it is a very important first step in planning your business. Having an idea is great, but an idea is not the same as a goal. Once you have a goal you can work on all sorts of ideas to reach it. Choose goals carefully, and then lay out an action plan.

For example:

Idea: I want to earn more money

Goal: By January 15, I will have $200 more a month to spend on my business

Methods

Action Steps

1. Get apart-time job. Research job opportunities and put together a resume

2. Raise my prices. Investigate competitors prices to see if there is room for a price increase

3. Cut my costs. Search for less expensive sources of goods

4. Win the lottery! Buy lottery tickets and keep your fingers crossed!

Establishing goals gives you a yardstick to measure your performance as you progress through life. Goals are very personal -- there are no right or wrong answers. Only you can determine what goals are appropriate.

Guidelines for Goal Setting

GUIDELINE 1: Your goals should be your own. YOU must be committed to your goals.

It is natural to share goals with other people, such as a spouse or an employer. When you decide to accept the goal of another person as your own, consider whether it is consistent with what you want. If you cannot commit yourself fully to the goal then you are probably going to fail.

Sometimes it is a good strategy to accept another person's goals temporarily in order to achieve one of your own goals. For example, if you want to start your own business, but lack essential management experience, you may decide to accept the goals of an employer for a time. This will help you gain valuable experience and skills before going into your own business.

GUIDELINE 2: Goals should be specific. They are most useful if they are concrete, clear, and written.

Writing down your goals helps to clarify what you want. You may be saying to yourself, "Oh, I can keep track of my goals in my head." Many people try to do this. Usually their goals become just vague ideas when they try to express them later on.
Start writing down some goals right now! To begin with, you can start with vague ideas you carry around in your head. Do not worry about being specific at this point. That will come later. Write whatever comes to your mind. Do not worry about whether the ideas are large or small, long-range or short-range, simple or difficult. The task is to get something, almost anything, down on paper. You can make them more specific later.
Review what you have written. Is anything keeping you from working toward these things? Choose one of your ideas and write it below in a form that is clear, concrete and specific.

GUIDELINE 3: Goals should be measurable so that you can tell when you have accomplished them.

Probably the easiest goals to measure are financial because they can be stated in dollars and cents. Others are somewhat more difficult to measure. Here the question you ask yourself is, "How will I know when I have accomplished my goal?" Suppose your goal is to have a successful business. How will you measure this success? In profit? In growth? In the number of customers or clients you serve?
Measurable goals help to keep you from getting discouraged. It gives you the pleasure of saying "I DID IT!"

GUIDELINE 4: Goals should be set for a definite time.

You have heard people say that they work best under pressure. If you are working toward your own goals then YOU must provide the pressure. One way of doing this is to set deadlines and timetables. Remember to make them reasonable. If you consistently underestimate the time it will take to accomplish a goal, you set yourself up for failure. If you give yourself too much time, you may simply forget about the goal for lack of pressure. You may lose enthusiasm or you may put off working toward your goal until near your deadline and then have to work in "overdrive" just to get done on time.

When you set deadlines and timetable, avoid being so ambitious that you exhaust yourself. Arrange tasks so that you can pace yourself and take breathers, as you need them. If you pace yourself effectively, you will begin to increase your confidence in your ability to accomplish goals that are even more challenging.

Consider the time you have available. Break it down into separate tasks and set a deadline for completing each task. Finally, decide how you are going to remind yourself of each deadline. Will you attach a list of deadlines to your mirror, desk, or bulletin board where you will be reminded of them often? Will you note your deadlines in an appointment book? Whatever you decide is fine, as long as it is consistent with your own way of doing things.

GUIDELINE 5: You should set both short-range and long-range goals.

Some people recommend establishing long-range goals first; others say start with short-range goals. The point is to start somewhere! Once you form the habit of goal-setting, you are likely to find that you can work either way, and back and forth.

If you have specific long-range goals, you can develop short-range goals consistent with them. If you have a short-range goal that seems to be inconsistent with your long-range goals, you must make a decision. Will you take a temporary detour? Will you eliminate your short-range goal? Will you alter your long-range goal?

GUIDELINE 6: Your attitude toward your goals should be flexible.

You should always have the right to change your mind. Studies of people over different periods of their lives indicate that as people get older; their priorities are likely to change. At one point in your life your work may be the most important thing to you. At another point, your leisure or community may be the most important. Goals should allow for changing priorities.

A more realistic sense of how long it takes to accomplish things will come as you gain experience at setting and working toward goals. Allow yourself flexibility in working style and timing.

Understanding Your Personal Profile

What do I need to think about before I start my own business?

- Am I the type of person to own and operate my own business?
- Do I have the knowledge necessary? How much income do I need to survive in the first years?
- How much income will this business generate?
- Do I have a product/service that people want?
- Are there already too many people doing this?
- Where will I get the money to start the business?
- Am I prepared to work the long hours it takes to build my business?
- Can I do it by myself or will I need employees?

What are my commitments?

- What level of attention will I need, can I give to starting a new business?
- List all the commitments in your life, including personal and business. On a scale of one to ten, where would you place your various commitments?

- Where do you place your commitment to start a new business?

Do I have the "know-how"? - Use the "Know-how" sheet to help you think about your readiness to start a business.

1. I have no problem keeping my checkbook straight.

Agree				Disagree
1	2	3	4	5

2. On days that I have a lot to do I have no trouble getting everything done.

Agree				Disagree
1	2	3	4	5

3. When someone comes to me with a problem I can usually figure out a solution.

Agree				Disagree
1	2	3	4	5

4. On days when I have more to do than I know I can handle I have no problem asking for help.

Agree				Disagree
1	2	3	4	5

5. Or just assigning duties to others.

Agree				Disagree
1	2	3	4	5

6. When faced with problems "down-the-road" I am able to plan for them and then carry out that plan.

Agree				Disagree
1	2	3	4	5

7. I have no problem communicating to others what I want done. (They usually understand what I want)

Agree				Disagree
1	2	3	4	5

8. I enjoy working with numbers and interpreting what they mean.

Agree				Disagree
1	2	3	4	5

9. I read quite a bit. (one book per month, daily newspaper, monthly magazines)

Agree				Disagree
1	2	3	4	5

Budgeting and Financial Planning

Take some time to think about your personal financial needs and resources. You need to consider how well you will be able to support yourself during the business start-up. Use the **Personal Balance Sheet** and **Cost of Living Budget** as tools to get a good picture of your financial situation.

Budgeting and Financial Planning

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Personal Balance Sheet

Assets	
Cash - checking accounts	$__________________
Cash - saving accounts	$__________________
Notes/Contracts owed to you	$__________________
Certificates of Deposit	$__________________
Life Insurance (cash value)	$__________________
Securities - stock, bonds	$__________________
Real Estate (market value)	$__________________
Vehicles (market value)	$__________________
Individual Retirement Plans, etc.	$__________________
Other Assets (specify)	$__________________
Total Assets	**$__________________**

Liabilities	
Current Bills You Owe	$__________________
Mortgages on Real Estate	$__________________
Loans You Owe	$__________________
Taxes You Owe	$__________________
Other Liabilities	$__________________
Total Assets	**$__________________**

Net Worth

Total Assets minus Total Liabilities= $__________________

Cost of Living Month Budget

Regular Monthly Payments	
House payments (principal, interest, taxes, insurance) or rent	$__________
Car payments (including insurance)	$__________
Appliance, TV payments	$__________
Home improvement loan payments	$__________
Personal loan, credit card payments	$__________
Health plan payments	$__________
Life insurance premiums	$__________
Other insurance premiums	$__________
Savings/investments	$__________
Total	**$__________**
Household operating expense	
Telephone	$__________
Gas and electricity	$__________
Water	$__________
Other household expenses, repairs, maintenance	$__________
Total	**$__________**
Personal Expense	
Clothing, cleaning, laundry	$__________
Prescription medication	$__________
Physicians, dentists	$__________
Education	$__________
Dues	$__________
Gifts and contributions	$__________
Travel	$__________
Newspapers, magazines, books	$__________
Auto upkeep and gas	$__________
Spending money and allowances	$__________
Miscellaneous	$__________
Total	**$__________**
Food expense	
Food - at home	$__________
Food - away from home	$__________
Total	**$__________**
Emergency/Contingency Fund	**$__________**

Total **$________________**

RESEARCH

Looking at the Industry

You will need to analyze the status of the industry and forecast the conditions in which your business now operates or will operate in the future. There are two very strong reasons to do an industry analysis. First, it will give you an awareness of and ability to anticipate the future of the industry and your business. Second, it is an important part of your business plan. Financial institutions will require it before agreeing to capitalize your business. You will want to consider:

1. **Industry Definition**

Find a definition that is broad enough to include all of your major competitors, but specific enough to permit useful comparisons. A definition that is too broad is better than one that is too narrow.
The industry definition should include:

- Economic sector -- manufacturing, distribution (wholesale or retail), services, etc.
- Products or services -- a list of what is offered by the industry
- Geographic scope -- local, regional, national, or international (This is for the overall industry and is determined by the markets in which most competitors, not by the size or scope of individual companies, offer products or services.)

The industry definition may also include a listing of major products or market segments. For example, a computer manufacturer may divide its industry into five market segments: personal computers, microcomputers, minicomputers, main frames, and businesses that do not involve computers. Few competitors operate in multiple segments; most operate in only one or two.

2. Industry Size and Growth Rate

Determine the current size of the industry for the company's product or service. To determine size of the industry, refer to published data and talk to experts. Although there is plenty of information available, most small companies will find it difficult to use. Most data available will frequently not correspond to industry definition and geographic scope as selected by the company. Therefore, industry size and growth must be estimated. You can also estimate industry size by estimating the sizes of the company's competitors and totaling these estimates.

Estimate the total industry size in annual dollars or units. From this, determine the industry annual growth rate and compare it to the projected annual growth rate for the company. You will gain valuable information by estimating your competitors' growth rate relative to your own growth. Growth rate may also be stated in terms of percentage increase or decrease in growth. If sales data are not available or are inapplicable, unit volume production or employment may be used. Explain your company's position in relation to the industry as a whole. At what rate is the business growing as compared to the industry? Sources for industry information include the Government, industry associations, and general business publications, which are available at most large public libraries.

Talk with your business counselor about the best way to proceed given your business.

3. Key Growth Factors

Key growth factors are trends and conditions beyond the control of the industry or of the companies within the industry. For example, the growth factors that influence a small manufacturer of electronic parts for automobiles include automobile production in the United States, economic trends in the United States, and trade relations between the United States and foreign manufacturers. The effects of these events on a small company may not be apparent; nonetheless, they are quite real.
It is important to identify negative as well as positive growth factors. If you list many growth factors, highlight the most important ones. Some factors that affect growth are:

a. Cyclical

Cyclical industries are those whose long term performance rise and fall as a result of external economic cycles, usually the national business cycle. Cyclical industries generally do well during periods of strong growth and do poorly during recessions. Typical cyclical industries are automobile manufacturing, residential construction, air travel, and machine tool manufacturing.

There are a few counter-cyclical industries. These industries do relatively better in recessions than in good times. Portions of the construction industry exhibit this pattern, because the government may fund public works projects during recessions to offset unemployment.
Cyclical patterns for local or regional industries should be identified and specific strengths or weaknesses associated with the locality should be stated.

b. Seasonal

Seasonality refers to the distribution of business activity throughout the year. Identify the industry's seasonal pattern and estimate the sales distribution throughout the year. If an industry lacks a seasonal pattern, it is reasonable to expect that its sales will be distributed evenly throughout the year. Seasonal industries have a disproportionate amount of activity in one part of the year and correspondingly less in the others.

c. Other Growth Factors

List other factors that may affect the growth of the industry - such as laws and regulations on the horizon; political climate; technology, etc.

Looking at Your Market

Your "market" is made up of your customers and prospective customers. You must understand who they are, how many there are, and how your business will serve them. Many new businesses will have multiple markets. Go through this exercise for each one, determining sales volume for each. This is an extremely important exercise, since you cannot calculate your income if you cannot calculate the size of your market!

Step 1: Describe your customer

Commercial Markets:
If your customers are other businesses, identify the characteristics of your typical business customer.

- Industry
- Key Reasons for Buying (Hint: the two primary reasons business buys from business is profitability (or the promise of it) and delivery when they **need** it.)
- Age of Business
- Minimum purchase amount

Consumer Markets: If your customers are members of the general public, the following identification of characteristics may be helpful.

Demographics

- Gender
- Income level
- Education
- Age range
- Occupation
- Marital status
- Family status

Psychographics:

- Lifestyle
- Buying Behavior - What needs/wants will your product/service meet?
- Buying Occasion - Gifts, daily consumption, long term purchase, etc.

Step 2: Determine the location of customers

Think about the customers you described in Step 1. Where are large numbers of them located? What distance are customers willing to travel to buy from you? What distance will you travel to sell to your customers?

Step 3: Determine the number of potential customers

How many of the customers you described reside within the geographical limits you have determined? This step requires doing quite a bit of homework. If selling to the general public, you need to look at some census data. If selling to other businesses, there are many potential sources of information. One of the best is trade associations. If you have done an Industry Analysis, that should have given you some idea already.

Step 4: Determine the number that will purchase from you

This is a very tough question! You need to consider your competition, both in numbers and quality. You also need to realize that some potential customers will not purchase the product or service from you or a competitor. To come up with an estimated customer base:

1. Estimate a number of potential customers that will purchase the products or services you offer, either from you or a competitor.
2. Estimate what percentage of those who do make a purchase, will choose your business.
3. Multiply the above number and percentage together to determine number of potential customers that will purchase from your business.

Step 5: Determine average sales per year per customer

Use your industry research to answer the following questions:

1. How many purchases will the average customer make during a month?
2. How much will the average customer spend for each purchase?

Multiply these two figures together to determine the amount an average customer will spend each month. You can now determine your annual sales estimate per customer.

Step 6: Determine your annual sales volume

You now know the number of customers and the average amount each customer will spend per year. Multiply these two figures together to calculate your expected annual sales volume.

Step 7: Evaluate the annual sales volume figure

Does the number you calculated in the previous step make sense? If not, go back to the first step and try again.

Choosing a Legal Structure

One of the most important decisions you will make is how to set up the business. You should read about the different legal forms, discuss your options with a business counselor, and talk with a lawyer. You will need to consider:

- Legal restrictions
- Kind of business operation
- Need for capital
- Tax advantages or disadvantages
- Liabilities assumed
- Decision-making
- Intended division of earnings
- Number of people associated with the venture and their specific roles
- Perpetuation of the business

Recognized Legal Structures[1]
1. Sole Proprietorship
2. Partnership
3. Corporation or "C-Corp"
4. Close Corporation or "S-Corp"
5. Limited Liability Corporation or "LLC"

1. Sole Proprietorship - Business entity owned and operated by one person. This is usually the least costly way of starting a business. You can form a Sole Proprietorship by finding a location and opening the door for business. There are the usual fees for registering your business name and for legal work in changing zoning restrictions and obtaining necessary licenses. Attorney's fees for starting your business will be less than for the other forms because there is less document preparation required.

Advantages	Disadvantages
a. Easiest to get started	a. Unlimited liability
b. Greatest freedom of action	b. Death or illness endangers business
c. Maximum authority	c. Growth limited to personal energies
d. Income tax advantages in very small firms	d. Personal affairs easily mixed or confused
e. Problems with isolation	e. Social security advantage to owner with business

[1] *This vary from country to country*

2. Partnership - A legal business relationship of two or more people who share responsibilities, resources, profits and liabilities. You can form a partnership simply by making an oral agreement between two or more persons. However, we recommend you consult your business counselor to have a Partnership Agreement drawn up to help identify and resolve potential future disputes. Most lenders will not capitalize a partnership without a partnership agreement.

A partnership agreement should include the following:

1. Type of business
2. Amount invested by each partner
3. Division of profit and loss
4. Compensation for each partner
5. Distribution of assets on dissolution
6. Duration of partnership
7. Provisions for dissolving
8. Provisions for withdrawals or admission of additional partners
9. Dispute settlement clause
10. Restrictions of authority - expenditures
11. Settlement in case of death or incapacitation

<u>Advantages</u>
a. Two heads are better than one
b. Additional sources of capital
c. Better credit rating than corporation of similar size
d. Ease of formation

<u>Disadvantages</u>
a. Death, withdrawal, or bankruptcy of one partner
b. Difficult to get rid of bad partner
c. Hazy line of authority.
d. Personally liable for business debts.
e. Divided authority.

3. Corporation - A voluntary organization of persons, either actual individuals or legal entities, legally bound together to form a business enterprise.
"C-Corp"

The corporation or "C Corp" is by far the most complex of the business structures. As defined by Chief Justice Marshall in a famous decision in 1819, a corporation "is an artificial being, invisible, intangible and, existing only in contemplation of the law." In other words, a corporation is a distinct legal entity, separate from the individual who owns it.

Advantages	Disadvantages
a. Limited liability for stockholders (While true for big business, may not be true for small business)	a. Gives owner a false sense of security
b. Continuity	b. Heavier taxes
c. Transfer of shares	c. Power limited by charter
d. Easier to raise capital	d. Less freedom of activity
e. Possible to separate business functions into different corporations	e. Legal formalities
f. Transfer of shares	f. Expensive to start
	g. Increased accounting

Close Corporation or "S-Corp"

The close corporation or "S-Corp" is a form of corporation that allows the incorporation greater tax advantages than with a regular (C-corp) corporation. Significant differences from a regular corporation include no corporate tax (you are taxed the same as a partnership); you are allowed only 35 shareholders; you are not required to hold an annual meeting; and you don't need to adopt by-laws. The close corporation offers the same corporate "veil" as does the regular corporation, however many other advantages of a regular corporation are not enjoyed by the close corporation. Consult your business advisor, lawyer or accountant for more details.

Limited Liability Corporation or "LLC"

The Limited Liability Company (LLC) is the "new kid on the block." It is neither a corporation nor a partnership but has elements of both. It is treated as a corporation for purposes of limited liability and as a partnership for purposes of taxation. LLC members can fully participate in management decisions while being fully protected from personal liability. The LLC can be run by a manager or by its members. But an LLC is not all "gravy." Setting up an LLC has elements of both a corporation and a partnership. There is extensive pre-work set up and significant filings. However, once set-up, the LLC is probably the best form of business entity for owners for whom liability is a major issue. Again, consult your business advisor and lawyer to make a comparative analysis.

Writing a Business Plan

1. Why write a plan?

- The thinking involved in answering the questions posed will force you to take a thorough look at your whole business rather than focusing on an individual piece of it.
- The completed plan can serve as a feasibility study to help you evaluate a new business idea or the continued success of an existing business.
- The completed plan will be a tool to help you more successfully manage your business operations.
- The completed plan will help you communicate your business ideas to persons outside your business and can be a starting point for constructing a financial proposal.
- Businesses managed from a plan rather than by "the seat-of-the-pants" are more successful.

2. What should I include?

I. Introduction/Summary

The Introduction/Summary should be statements of facts about your business and should summarize the more important points of your plan.

<u>Purpose of the Plan:</u> a brief statement of why you are writing this plan i.e., performance tool, pursuit of financing, etc.

<u>Type of Business:</u> Give your trade name and brief statements about your business structure i.e., sole proprietorship, partnership, etc.; the industry (retail, service, agriculture, etc.) in which it will operate; the product/service you are offering; and whether it is a start-up, expansion, or the purchase of an operating business.

<u>Business Objectives:</u> One sentence "bullets" that start with the word "to" that itemize what you wish to accomplish in the first year (start-ups) or the next two years: These statements should be measurable and within clear time frames. Objectives can include sales, production, profit margin, market share and/or penetration.

<u>Ownership:</u> A list of the owners, their percent of ownership, and a brief statement of their experience in the business.

<u>Loan Usage:</u> State whether the loan will be used for working capital, equipment purchase, or some other purpose.

II. Business Activities

This section describes what the business does, its environment and how it will succeed.

Product Description

1. Describe your product/service in detail including references to blueprints, drawings, charts, layouts, etc. (These should be appendices.)
2. Present your product/service by name and by market position, i.e. theme, bundle of values, uniqueness.
3. List your price(s) and describe what strategy you employ over what time frames.

Industry/Business Analysis

This is an analysis of the current status of the industry in which your business resides. It provides a basis of comparison for your business.

1. Definition
2. Industry Size and Growth Rate
3. Key Growth Factors
4. Analysis

Competition Analysis

The Competition Analysis is key to determining whether or not you can grab a share of the market and hold it. It is simply a review and comparison of five of your nearest competitors. The criteria for comparison are:

Image: This includes both the reputation of the business plus the physical portrayal of the business.

Location: This entails the customer access, visibility, as it pertains to the ability to attract the market.

Layout: (For retail and in-store services) Consider the physical layout of the floor space and what it does or does not do to attract the customer.

Products: List the products the business offers to the customer. Include any unusual differentiation.

Services: Consider the quantity and the quality of the services being offered.

Pricing: List the prices per product/service offered. Consider the strategy they seem to be employing (i.e. penetration, prestige, skimming, etc.)

Advertising: Determine how the business is getting their message out to their customers. Consider sales force, public relations, and special promotions as well as advertising.

Marketing Plan

This section will contain your plan to get your message about your product/service to your customer. It will include:

1. Product
   Describe your product in terms of your product's attributes. What it is about your product/service that makes the consumer want to purchase it. Examples: low price, prestige, fast delivery, high quality, status, style durability, reliability, sense of adventure.

2. Customer Profile
   Define your market and describe the size, density, and expected share.

3. Distribution
   Describe how you intend to move your product from its point of production to your customer.

4. Promotional Scheme
   Describe how you intend to carry your "marketing message" to your customer.

III. Management

This section includes a description of the management of your organization including position responsibilities and functions.

A. Organization

Provide a functional organization chart showing positions (by position title) and functions within the organization. Provide a listing of services you intend to purchase/subcontract and whom you intend to hire (lawyer, accountant, etc.)

B. Personnel

Provide a list of positions, number of employees in each position, weekly salaries, and totals. Provide a schedule for hiring and a list of resources for hiring. Provide a copy of your 'conditions of employment', personnel policies, salary levels and fringe benefits as an appendix.

III. Financial Information

This section shows the lender(s) the need for capitalization and your ability to repay it. The information must be consistent from form to form. An existing business will show statements for the last three years of operation. Start-ups will show a balance sheet at the time of start up and projections for the first three years.

- Financial statements include an income statement, balance sheet, and cash flow: existing businesses for the previous three years and for the future three years; startups for the future three years only.
- Include personal financial sheets for all principles of the business.
- If purchasing an existing business, include financial statements for the previous three years and an appraisal form.
- Provide a capitalization plan identifying all resources of start-up capital and list equipment, other fixed assets and inventory that will serve as collateral to financing. Include relative values.
- A statement specifying how loan funds will be utilized.

V. Supporting Documents

Attach any other document that will strengthen your plan by supporting your capabilities. Include survey results, letters of reference, contracts, leases, letters of intent, sales agreements, resumes, personnel policies, job descriptions, and credit reports.

3. What do I do with the plan once it is completed?

- It is a chance to try out new ideas and to make mistakes on paper rather than in the real world with real people and real money.
- The plan is a tool to measure your business performance in terms of organizational performance and financial operation. Your business plan will set objectives regarding both. These objectives should be reviewed periodically, quarterly, every 6 months or yearly.
- Any realistic attempt to borrow money for your business must include such a plan for a lender to make judgment on the potential of your business for success.

FUNDING

Loan Considerations

There are a number of factors that are considered when lenders review loan applications. There is no set formula, but it is helpful to understand the areas that a lender will look at. Your goal is to prove that you are a good candidate based on all these factors. Be persuasive and look for ways to state your case. Give examples to demonstrate. Trying to get a loan can be like trying to get a job - be prepared to be your own advocate, to sell yourself and your concept.

7 C's of Lending

1. Credit
2. Character
3. Capacity
4. Capital
5. Condition
6. Capability
7. Collateral

Credit

This is your history with debt. We advise getting a free copy of your credit report as soon as you know you will need money, and start working to fix past problems. There is a difference between credit problems that are crisis-related and chronic credit issues. For example, debt from medical emergencies is considered differently than perpetual and increasing credit card debt. Generally, lenders are more understanding about debt that arises from a one-time life crisis. Even if you have had past problems, you can get a loan if you show effort to repay. Lenders want to see a minimum of 6 months steady payment.

Character

This is your personal commitment to pay. Lenders want to see that you are a reliable, responsible person. Negative issues include criminal convictions and bankruptcy. Positive attributes are shown in a good resume, involvement in the community, and letters of reference.

Capacity

This is your ability to pay back what is loaned. Lenders want you to have enough money to succeed. They will look at your savings, your household income and expenses, and whether you have realistic expectations about business income. They want to see that you will be able to cover your monthly living expenses.

Capital

This is the amount of cash that you (and family) are willing to invest. Lenders want you to show that you'll put your own money behind your idea and, thus, are willing to share the risk. Banks generally expect that your provide 20% of the total dollar amount required. Other lenders may expect less.

Condition

This is the state of the economy and the industry your business will operate in. It may not be something you can change, but the lender will consider the big picture and your understanding of it. For example, opening a typewriter business considering today's trend towards computers may not be favorably viewed.

Capability

Can you do what it takes? Do you have the skills and experience? Do you have the time and energy? Do you have support from family and/or friends? Can you manage other responsibilities and the business at this point in your life?

Collateral

This offers the lender security and shows commitment from you. Ideally lenders want to have loans secured 100% by other items of value. Since microenterprise loan is based on future income, character lending is usually observed. It can include items that are purchased with the loan, like a building, vehicle, or equipment.

The Application Process

Applying for a loan can be an intimidating process, but if you are prepared and seek assistance from others, it can be very manageable. The key to success is putting time into writing a well thought out business plan. You will want to think about how much money you will need, if it is realistic to take on that amount of debt, and if you have achievable business goals. Once you figure out what you need, it will be easier to find a source for that money.

The Ten Steps to Getting Money for your Business

1. Consult a business counselor to help you decide if and when you will need the money
2. Approach the bank you currently do business with and let them know you are thinking about applying for a business loan
3. Get your credit report (Link to credit repair)
4. Research your business concept and write your business plan (or update it if you are an existing business)
5. Get feedback on your plan and make revisions
6. Put together your loan application
7. Prepare for interviews with loan officers
8. Submit your application and be prepared to provide additional information, if necessary
9. If you application is denied, ask the lender why, and consider revising and re-submitting it
10. If your application is denied and the lender says you would not be eligible for a loan, talk with your business counselor about other ways you might be able to get your business started or what steps you might take to get your business started down the road

GROWTH

Growing your business is similar to starting a business. It requires goal setting, evaluation, research, and funding.

1. What type of financial record keeping do I need?

Most small business use single entry bookkeeping, an entry is made in your books for every financial transaction. All of the money coming in to the business from sales goes on the income side of your books; all of the money going out for supplies, rent and other costs of running the business goes on the expenditures side of your books.

A single-entry bookkeeping system is relatively simple to set up. All you need is a book or computer program in which you can record your daily receipts and expenses. Your "books" can, in fact, be just one or two books - a multi-columned, lined pad will serve many people just fine.

2. Do I need a computer?

Computers can be a useful tool for managing information, but remember, they never DO the work for you. It is also important to have a back-up way of doing things, in case your computer breaks down. Business owners can use computers in a variety of ways: creating professional-looking documents, researching on the Internet, communicating via fax or e-mail, keeping track of inventory, keeping the books, etc. You must look at your own needs and decide if the computer will make your job easier or harder.

3. Who are my customers?

The simplest way of doing it on your own is to engage is some common-sense market research: Ask your friends and family for anything they know about your potential customers. Go to trade shows or engage in networking with other professionals. If you are considering a storefront, talk to pedestrians who shop in the area where you think you would like to set up shop. Subscribe to publications that cover the business or trade you are interested in.

A more complicated way of doing it on your own - and probably a more accurate way - is to conduct a full-fledged market research survey. There are three steps in a standard market research survey:

- Create your "typical" customer profile, that is, figure out who you think your customer is
- Conduct a survey or surveys of people fitting that profile
- Analyze your results to determine whether you can put information you've learned about your market to profitable use, and then follow up on your findings

4. How do I get more customers?

Get the word out! Let people know what you have to offer. Think very carefully about your marketing strategies. It is NOT just advertising. It includes things like networking, PR, building loyalty with existing customers, and building an identity and reputation for your business. Some of the most effective ways to get customers are the least expensive. For example, always having business cards with you and handing them out at every opportunity. Allow the people you know, particularly your existing customers, to be your sales people.

5. How do you conduct a market survey?

There are many means to gather data after you profile your customer: personal interviews, telephone interviews, mail interviews, group interviews/focus groups, and test marketing. Anyone who starts a business on a part-time basis while still holding a full-time job is, in essence, test marketing. In the final analysis, once you have completed your research, you can put the information you have gathered to good use. You can modify your products, services or location, do more research to make yourself more distinctive in the marketplace, or otherwise act on the material you've gathered to improve your start-up prospects.

TOOLKIT 2
MARKET DESIGNS; RESEARCHING MARKETS FOR YOUR SERVICE BUSINESS

Part I: Identifying Your Market

Categorically Speaking

There are several ways to look at service businesses. We try to address these different categories throughout the workbook.
For example, some businesses sell what are generally known as professional services. These would include groups like doctors, lawyers, architects, engineering firms, accountants, advertising agencies, and business consultants. There are also trade professional services. These can include everything from plumbing and electrical contractors to cleaning services and caterers.

Another way to categorize businesses is by their customer base. Some service businesses sell their services to private individuals-much like a homeowner may hire a cleaning service to come in and clean the house. Other service businesses, such as an ad agency for example, only sell their services to other businesses or organizations. And some service companies market to both individuals and groups.

The point of all of this is that these characteristics about your business have an impact on your market research, so it's important to know where you fall.

Market Research: The Adolescence Of Marketing

Every entrepreneur knows that marketing is one of the keys to success in business. Marketing, itself, is a big business. Bookstores are full of books and other publications that tell readers how to do it. Universities set up entire Marketing Departments to teach students how to do it. And just about every company-and even a lot of nonprofit organizations and government agencies-has some sort of marketing program in place.

The textbooks define marketing as the four functions used to create a sale-the four P's of marketing: The right product to the right place at the right price through promotion. The goal is to put together a marketing mix that will produce the most profit.

But when you strip it down to the basics, a good marketing program is really a good communications program at its heart-a message, an audience, and a medium. The message includes the services you're selling and the sort of response you're seeking from your target audience (such as "Pick up the phone and call us today," for instance). The audience is made up of all the different customers you want to sell those services to. The medium is the link you use to bring the two together. If you do it right, your medium (or more likely, your media) can also let your audience send their own messages back to you-messages about their likes and dislikes, about their needs, about their perceptions of your services.

Helping you with the second piece of this puzzle identifying your audience, targeting your customers and clients-is our main goal in this booklet.

Just What is A Market Anyway?

Before you can start researching markets for your service, you need to know what you are looking for. You need to understand what a market is. Simply put, markets are made up of those people, businesses, agencies, organizations, and other groups who have a need or a desire for your service. Need and desire are not enough, however. What you really want are those customers who not only want or need your services, but who are also willing and able to pay for them.

Begin thinking of your market not as one group of customers, but as a whole group of groups of customers. To put it another way, you really are not dealing with just one big market, but rather with several smaller ones. The real trick is to get specific-as suggested by the target below.

For instance, if you think your market is the "general public," you may want to reconsider that. Your potential markets are probably smaller and more specific-and more numerous-than you may think at first.

The Example of the Broken Window

Suppose you want to offer your services as a glazier, for example. (A glazier is one who cuts and installs glass, by the way.) Suppose, too, that you want to specialize in repairing broken windows. On first thought, your market is the public, because no one knows when he or she might have to have a cracked or broken window replaced, right?

Well, perhaps. If you think more about it, though, you will realize that your market really is not the public. Your market is that part of the public who has a broken window right now. No one else could care less that you repair broken windows. They do not need you.

All of a sudden, your market has gotten substantially smaller. What's more, just because a person has a broken window does not automatically make that person a part of your target market. These potential customers have to want to get the window fixed, and they have to be willing and able to pay to have the work done by someone else like you. So once again, your potential market shrinks even more. This is good, though, because when you find these people, you have found motivated buyers. Moreover, motivated buyers add up to sales.

These are not your only market, however. What about the people who can refer business to you? These referral sources are also markets for you to identify and target. These markets might include glass suppliers or hardware stores-or even insurance companies, since they are usually the ones footing the bill.

Another referral market might be those people who are friends or family members of the people with the broken windows-because they can become an unwitting sales force for you: "Say, Bob, I couldn't help noticing that huge, jagged hole in the picture window in your living room. Have you thought about calling Jagged-Holes-In-Glass-R-Us?"

Again, one of the key market research skills you can develop is to get as specific as you can in defining your markets while at the same time identifying and listing as many of these specific groups as you can.

Know Thyself

Before you can generate lists of specific markets, you will want to make sure you have a clear-and specific-idea of what services you want to sell. After all, you cannot do good market research until you know what you want the market to buy from you.

If you are lucky, you will know what services you want to sell, and you will have already developed the skills required to provide them. Focus on what you like and what you are good at. More than likely, they are the same things. They are usually a good indicator of what niche you should aim for in the marketplace.

After all, if you have never spent much time tinkering with car engines, then it does not make a lot of sense for you to start a business as a mechanic. Besides, if you are going to start your own business, why go out and do something you do not really enjoy?

Notes on Niches

If you can find a niche, you will have something you can build on in your search for markets. That is why it is usually better not to try to be all things to all people. That approach will most likely create problems for you. When you try to do it all, you often end up doing things that you do not really enjoy doing. On the other hand, you end up trying to do so many different things that you never develop expertise in any of them. In addition, remember that your expertise is what people are buying-even if you charge by the hour. Your expertise and experience are what make your time, and services, worth paying for.

For example, if you are a dentist, do not just think of yourself as a dentist. Ask yourself what specific kinds of dentistry you like to do and want to do. Ask yourself what will make your particular practice of dentistry unique from all of the other dentists in your area.

Suppose, for instance, that you are a plumber and you have an interest in old historic homes. By combining these two things, you might be able to carve a niche as a plumber who specializes in updating the plumbing systems in older structures. Alternatively, maybe you are an insurance agent with a background in small business. Why not target small business owners since you understand their unique needs in a way that most other agents don't?

It is not enough to know that you are a good dentist, a good plumber, or a good insurance agent, however. You need to know how good you are. You need to have a reasonable idea of your strengths and weaknesses. Just because you have a law degree doesn't necessarily mean you're well-suited to take on any case that walks through the door.

Knowing your strengths and weaknesses will help you when you begin trying to identify your best potential markets/customers, as well as those markets that you probably will want to leave to someone else.

Building a Niche

Here are a few questions to help you focus on the services you plan to offer. Try to take your time in answering these, and go ahead and jot down your answers here or on a separate sheet. (Writing down your answers forces you to clarify things in your own mind. Just that act of translating your thoughts into words can really help you see where you know the answer and where you only think you know the answer. There is a difference.) And remember: Have fun with this. It is not a test, and no one is going to give you a grade on what you write here.

- Describe the services you plan to offer:
- Why did you pick those?
- What aspects of each one do you like doing the most?
- What aspects do you enjoy the least?
- What is unique about your services compared to those of your competition?
- What are your strengths?
- What are your weaknesses?
- Are your customers more likely to be individuals (people from the public, for example) or groups (organizations, associations, government agencies, industries, or other businesses)?
- In which specific geographic areas do you intend to market your services? Locally? Within surrounding counties? Statewide? Regionally? Nationally?
- What related services do you not want to provide?
- Describe the business you are in, as opposed to the services you offer.

Part 2: Market Designs: Competition

That Competitive Edge

In any size business, knowing who your competition is and what they are up to is an important key to success. It is particularly helpful in market research.

In a sense, there are two kinds of competition: competition that exists and competition that does not exist-at least not yet. If you are entering an established field, you will be facing the first kind. Take accounting as an example. If you are planning to go into business as a certified public accountant, then your competition, most likely, is going to be made up of all of those other CPAs and accounting firms listed in the yellow pages of your local telephone directory.

On the other hand, if you are introducing a new service, then you will not have to worry about direct competitors. Of course, you will have more work to do than if you were going into an established field, but once you create it and develop your markets, you will have them all to yourself-at least for a while.

That does not necessarily mean you will not have other kinds of competition, however. Competition can sometimes take the form of a market's reluctance to accept new ideas. For example, suppose you see a need for a widget delivery service in your area. Everyone has widgets and they need to have them moved from one place to another, but until now, no one has thought of creating such a delivery service. It is a great opportunity for you because there are no widget delivery services to compete with you. You will have a corner overall widget delivery market.

But when you look closer, you realize that over the history of widgets, people have worked out ways to get their widgets from one place to another-through the mail, for instance. Or through their friends and family: "Say, Bob, would you mind dropping this widget off at the cleaners for me on your way downtown?" Needless to say, competition is a slippery thing. It is not always someone sitting in an office or a shop down the street doing the same thing you are doing.

Sizing up the Competition

So what do you need to know about your competition? That is easy: As much as you can. Information is power. Here are just a few of the things you might want to try to find out.

(You may want to make copies of this worksheet so you can fill out a separate one on each of your main competitors.)

- Who are your competitors?
- How many of them are there?
- Where are they?
- How successful are they?
- Which ones are the main players and which ones are just barely hanging on?
- How long have they been around?
- What is the perception of them in the marketplace?
- How do they charge for their services?
- How much do they charge for their services?
- Which ones are seen as providing the best quality?
- Which ones are seen as providing the lowest cost?
- Which ones are seen as the fastest?
- Which ones are seen as offering the best value for the money?
- Which ones are the most successful?
- What niches do they each fill? What are their specialties, in other words?
- How much territory do they cover (meaning how large a geographic area do they sell their services in)?
- Who do they use as suppliers?
- What are their strengths?
- What are their weaknesses?
- What credentials do they have for doing what they're doing?
- What professional groups and organizations do they belong to or participate in?
- How do they market their services?
- Are they growing, shrinking, or remaining about the same in size?
- What is their favorite vegetable? Their least favorite vegetable?
- Where can you beat them? Quality? Price? Speed? Good looks? Sense of humor?

Going Undercover

We could go on, but this is enough to get you started thinking about your competition. Of course, the next question is where do you go to get the answers to all of these questions?

The easiest place to start your research is the telephone book. Take an hour or so some morning when you really do not want to get down working yet and browsing through the Yellow Pages. You would be amazed at what you can find out there who and where they are, how they position themselves in the market, which services they like to play up. Of course, there is a lot you will not find out there, too. Rates, for example.

So how can you find out this information? One way is to ask them. Just pick up the telephone, call your competition, and ask them how they charge for their services-by the hour, by the job, or by the position of the sun, the moon, and the planets. Or you can get someone else to make that call for you. Or you can call a friend or acquaintance who has used their services before and ask them how much your competition charges.

Or you can call appropriate trade associations to see if they have any industry statistics available. In addition, the information center at the Business Development Center has an incredible source of materials on all kinds of things including your competition.

As you go about doing this sort of research work, however, there are several things to keep in mind. First, remember that most businesses do not pass along proprietary information without good reason. Moreover, while government agencies sometimes have access to some proprietary information that does not automatically, make it available to you--or anyone else in the marketplace.

In most cases, if you want certain proprietary information about a company-its gross and net sales figures, for example-you are going to have to do some "primary" market research. In other words, you have to figure out a way to dig it out yourself. And chances are that you won't find it in a book on some library shelf or in an easy-to-access computer database.

Libraries and information centers like the one at the Business Development Center are excellent places to begin your search for "secondary" market research information. Secondary research includes information that has already been collected and reported by an association or other group-such as a salary survey conducted by a trade magazine, for example.

If you need help finding out about the kinds of information available to you at the Business Development Center or your local library, talk to the reference librarian. Be prepared to be specific about what you are looking for. The more help you can give the librarian about what information you want and how you want to make use of it, the more help the librarian can give you. Be aware, however, that you probably will not find proprietary information at the library-any library.

Part 3: Customers: The Hunt For Customers

Okay, you have decided what services you want to offer. You have identified the niches you want to target. You have analyzed your competition. Now it is time to get to the point of market research. It is time to find out exactly which markets you should be targeting and whether they are big enough to support your business.

The truth of the matter is that you probably already have a good idea of which markets you should be targeting. If you do not, it could be a sign that you are going into a business you do not have enough background and experience in. As we mentioned earlier in this workbook, focus on what you know and what you like.

Even so, there are usually more customers within those markets than you may be aware of at first. And digging for them isn't necessarily as hard as you might think. The following pages include notes, tips, exercises, and resources to help you build a clear picture of your various markets and make the best use of that information.

Learning To Think Like a Customer

If you want to succeed as a deer hunter, you have to think like a deer. And if you want to succeed in business, you have to think like a customer.

Here are a few questions to help you do just that (think like a customer-that is). The best way to do this exercise is to read the questions, then turn around, stare out a window, and try to put yourself in the place of someone who could use your services. After you have spent a few minutes doing this, go back to the questions and write down your answers-taking time to stare out the window again if you need to.

- Describe your idea of your typical customers or clients.
- What do you think your customers are looking for in a service like yours?
- How do you know?
- Where are your customers located physically? And what impact, if any, does that have on whether or not they do business with you?
- How important to your customers are the services you offer?
- What factors do you think will cause customers to pick you over your competition?
- If you were in need of your services, how would you go about trying to find them?
- What would be most important to you as a customer of your services?
- What would be least important?

Storm up Your Brain

Is another chance to stare out the window? Take at least 15 or 20 minutes brainstorm a list of as many markets and potential customers as you can, and write them in the space below. Include everything from general market categories to specific individuals.

The trick is to write down everything that pops into your head, no matter how ridiculous or implausible. You can always edit the list later, and besides, the weirdest item on your list may cause you to think of a great market you would not have thought of otherwise. When you fill up this sheet, continue your list on a blank piece of paper.

And remember. This is brainstorming. There is no right or wrong answers here. You are going for quantity, not quality.

Government publications and information services are also great sources to tap into. Government census data present a perfect example. The Census State Data Center at the University of Arkansas at Little Rock has special computer software that can provide you with a whole range of information about your market. You can get population data broken down into all kinds of categories-race, age, sex, family income, employment, education, and housing, just to name a few. These data can also be mapped for you according to very specific location criteria.

Other sources of information include trade associations and their related trade shows and publications. These can be an invaluable source of data on everything from salary surveys and market trends to company profiles and the key players in the industry. Your reference librarian can help you identify the trade organizations, shows, and publications that are best suited for your needs.

Part 4 - Your Market Share

One of the most important questions you will face is whether your market is large enough to support your business. Unfortunately, this is not an easy thing to determine. Even so, there are four basic places you can go to look for customers to make your business a success:

- You can create a market or a demand where none existed before. This can include customers for a new service you introduce in your market area. It can also include bringing new customers to an established service. For instance, by packaging your services to a particular target market, you may be able to show these potential customers that they need what you have to offer even though they have never used such a service before.

- You can serve those customers who are not already being served. This is the situation when the demand for your service is greater than the existing supply. This, of course, means that your market has customers who want your service, but they cannot get it because there are not enough providers of that service to meet the demand.

- You can take customers away from your competitors. This may seem a bit cold-hearted, but frankly, if you can provide those customers with better value, your competition deserves to lose them. That is what the free enterprise system is designed to foster-better value in the marketplace.

- You can expand the geographic area you serve to cover a larger number of customers. If you are only serving your neighborhood, you can expand to cover the entire city. If you are covering your local county, you can extend your services to surrounding counties, or even go statewide.

It helps to know how many customers you will need to be successful. One of the first things you will want to do is determine your "break-even" point-how much money your business has to generate to cover your expenses and pay you enough to make it worth your while to stay in business.

You also need to analyze your market to determine things like market potential, market size, and market share. Market potential is how much potential demand is out there for your service. Market size has to do with the current demand for our services. And of course, market share is how much of that potential and current demand you can expect to capture. When you compare your estimated market share to your break-even figure, you should be able to tell if the risk of going into business is worth the potential rewards.

Part 5: Research

Unbelievably, there is a wealth of information available to you as you go about your research of markets, potential customers, and the competition. The problem is that most of us do not realize just how much information is out there-and if we do, we usually do not know how to get our hands on it.

One of the best places to start is in the reference section at your public library, or better still, a resource center specifically designed for small businesses and entrepreneurs such as the one maintained by the Business Development Center.

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TOOLKIT 3
HOW TO PRICE YOUR PRODUCTS AND SERVICES

Successful small business expansions and new formations lead the way in creating new markets, innovations and jobs that fuel economic growth and prosperity.

In recognition of the importance of small business to building the economic stability of its members, credit unions want to meet the information needs of existing business owners and aspiring entrepreneurs.

Pricing

The primary goal of business is to make a profit. Many small businesses fail to do so because they do not know how to price their products or services. Pricing is the critical element in achieving a profit and is a factor that all firms can control.

Before setting your prices, you must understand your product's market, distribution costs, and competition. Remember, the marketplace responds rapidly to technological advances and international competition. You must keep abreast of the factors that affect pricing, and be ready to adjust.

Retail Cost and Pricing

A common pricing practice among small businesses is to follow the manufacturer's suggested retail prices. The suggested retail price is easy to use, but it can cause problems. It may create an undesirable price image, and it does not consider the competition.

Competitive Position

Another approach is a strategy in which a firm bases its price on those of its competitor. A small retailer should compare prices with a similar store. Do not try to compete with a large store's prices, because they can buy in larger volumes and their cost per unit will be less. Instead, highlight other factors, like customer service. Customers will often pay more for merchandise if they get courteous service.

Pricing Below Competition

Many vendors have been very successful using this pricing strategy. Since this strategy reduces the profit margin per sale, a firm needs to reduce its costs and:

- Obtain the best prices possible for the merchandise;
- Locate the business in and inexpensive location or facility;
- Closely control inventory;

- Limit the lines to fast-moving items;
- Design advertising to concentrate on "price specials";
- Offer no or limited services.

Pricing goods below the competition can be difficult to maintain. Why? Because every cost component must be constantly monitored and adjusted. It also exposes a business to pricing wars. Competitors can match the lower price, leaving both parties out in the cold.

Pricing Above the Competition

This strategy is possible when price is not the customer's greatest concern. Other considerations important enough for customers to justify paying higher prices include:

Service considerations:

- delivery, speed of service,
- satisfaction in handling customer complaints,
- knowledge of product or service,
- helpful and friendly employees,
- A convenient or exclusive location,
- Exclusive merchandise.

Price Lining

This strategy targets a specific segment of the buying public by carrying products only in a specific price range. For example, a store may wish to attract customers willing to pay over $50 for a purse. Price lining has many advantages:

- Reduced errors by sales personnel;
- Ease of selection for customers;
- Reduced inventory;
- Reduced storage costs, due to smaller inventory.

Multiple Pricing

This involves selling a number of units for a single price for example, two items for $1.98. This is useful for low-cost, consumable products like shampoo or toothpaste. Many stores find this a desirable pricing strategy for sales and year-end clearances.

Service Costs and Pricing

Every service has different costs. Many small service firms fail to analyze their services' total cost, and therefore, fail to price them profitably. By analyzing the cost of each service, prices can be set to maximize profits and eliminate unprofitable services.

Service Cost Components

Material, labor and overhead make up the total cost of any product or service.

Material Costs

This is the cost of materials found in the final product. For example, the wood and other materials used in the manufacturing of a chair are direct material.

Labor Costs

This is the cost of the work that goes into the manufacturing of a product. An example is the wages of all production line workers. The direct labor costs are derived by multiplying the cost of labor per hour by the number of man-hours needed to complete the job. Remember to use not only the hourly wage, but also include fringe benefits. These include: social security, workers' compensation, unemployment compensation, insurance, and retirement benefits.

Overhead Costs

Any cost not readily identifiable with a particular product is overhead. These include indirect materials and indirect labor, such as maintenance, supplies, repairs, heat and light, depreciation and insurance. These are not charged to direct labor, but must be included as a cost. Examples are clerical, legal and janitorial services and supplies. Insurance, taxes, rent, advertising and transportation are also overhead costs.

Part of the overhead costs must be allocated to each service performed or product produced. The overhead rate can be expressed as a percentage or an hourly rate.

Adjust your overhead costs annually. Charges must be revised to reflect inflation and higher benefit rates. It is best to project the costs semiannually, including increased executive salaries and other projected costs.

A cost lid must always be used in preparing a bid or quoting a job. Include shipping, handling or storage in the total material cost.

Figuring Costs and Profits for a Consultant Service

Pricing services, where your own labor or expertise is used, is different from pricing services that use materials and other labor. For instance, most consultants price their services by the hour. Senior consultants charge more for their time than do their less experienced counterparts.

Remember to charge for an adequate number of hours. Travel time is usually listed as an extra charge.

It is unlikely that all of your time will be billed to clients. Therefore, hourly or contract fees must be set high enough to cover expenses during slow periods. That is why one-half of the total normal working hours for a given year are used in figuring overhead rates. Try to obtain long-term, monthly, or contract assignments when possible.

Summary

Your pricing structure and policy are major components of your public image and are crucial to securing and keeping your clientele.

Pricing for service businesses may be more complex than retail pricing. However, the result is the same: cost, and operating expenses, and desired profit, equals the service's price.

The key to success is to have a well-planned strategy. Establish your policies, constantly monitor prices and operating costs to insure profit. Accuracy increases profits!

Toolkit 4
IMPROVING DECISION MAKING WITH SIMPLE BREAK-EVEN ANALYSIS

In your business planning, have you ever asked: How much do I have to sell to reach my profit goal? How will a change in my fixed costs affect my net income? How much do my sales need to increase in order to cover a planned increase in advertising costs? What price should I charge to cover my costs and allow for a planned amount of profit?

These are some of the questions that you can easily answer by using simple break-even analysis. In the next pages, you will learn what break-even analysis is; see examples of how the technique works in manufacturing, retailing, and service businesses; and find out how to use it in your own business planning. Break-even analysis is a very useful tool because it can help you understand the sources of profit in your business.

Basic Definitions

Break-even analysis is the use of a simple. Mathematical formula to determine the sales level at which the business neither incurs a loss nor makes a profit. The break-even point, in mathematical terms, is simply the point where:

Total Expenses = Net Sales Revenue

The amount of sales revenue should be readily available on your income statement as net sales. Net sales revenue is all sales revenue (often called "Gross Revenue") less any returns and allowances. If your business is brand new and you have no income statement yet, you will need to use a projected sales figure. This will work for any of the calculations outlined in this guide. Total expenses also appear on your income statement (or projections). You will find most expenses listed under the heading "Operating Expenses" or "General and Administrative Expenses." Additional expenses to include in your analysis are found on the line labeled "Cost of Goods Sold," which appears on income statements for retailers and manufacturers.

To use the break-even technique, you need to do further analysis of your expenses so that you can classify them as either "fixed" or "variable."

Total expenses consist of two cost components: **fixed costs and variable costs.**

Fixed costs are those expense items which generally do not change in the short run, regardless of how much you produce or sell. These costs are typically the expenses you pay out regularly that do not go up or down with your sales level. Examples of fixed costs include general office expenses, rent, depreciation, utilities, telephone, property tax, and the like. Obviously, all expenses vary over the long run. For example, rent and property taxes increase every year. In break-even analysis though, our calculations are based upon short-run information in order to reveal the current profit structure of the business.

Variable costs are those expenses that change with the unit level of either production or sales. Generally, these costs increase with increased production or sales because they are directly involved in either making the product or making the sale. Examples of variable costs for manufacturing firms include direct materials and direct labor. In retail firms, variable costs include the cost of goods, sales commissions, and billing costs. These are only a few of the many kinds of variable costs you will encounter.

Typically, service businesses do not have large variable costs, except for labor. Other expenses that may be variable costs for service businesses include: materials routinely given to clients, materials used to offer their service, the cost of hourly labor to provide the service, and commissions paid co individuals who sell the service.

Using the definitions provided above, you should be able to classify all of your expenses as either fixed or variable. To begin the classification process, make two lists. Label one "fixed" and the other "variable." Record each of the expense items that you located on your income statement or projection on one of these lists. If you are not sure which list is right for a particular expense item, use this test to determine if it is fixed or variable. Ask yourself: *If I did not sell any of my products or services during the next month, quarter, or year (whichever period is relevant for your break-even analysis), would I still have to pay this expense? If the answer is yes, that item is a fixed cost.*

Some items may seem to have both fixed and variable cost characteristics. If that is the case, try to determine what portion of the cost is fixed and what portion is variable for your two lists. For example, you might labor cost if your staff is involved in production and administration of the business into 60 percent variable and 40 percent fixed. This step involves a good deal of judgment, so don't be too concerned about making inexact choices. Just make sure you have good reasons for your classifications. With the information you now have, we can adjust the break-even formula to serve better as a planning tool. Substituting the sum of (Fixed Costs + Variable Costs) for the term "Total Expenses," we get:

Fixed Costs + Variable Costs = Net Sales Revenue

There is something slightly misleading about the formula as it stands, however. As you know, variable costs change with the unit level of production or sales. In general, as the number of units flowing through the enterprise increases, to variable costs increase. For a manufacturer, the total variable costs increase as the flow of production or sales of the product increases. For a retailer, the total variable costs increases as the time it takes to purchase, inventory, and resell the product increases. So the "Variable Costs" part of the formula should reflect the changing nature of the level of units flowing through the business. That can be done mathematically by expressing the amount of Total Variable Costs as the Variable Cost per Unit multiplied by the Sales Volume.

We now have the final form of the basic break-even formula:

Fixed Costs + (Variable Cost Per Unit it Sales Volume) = Net Sales Revenue

Break-Even: Basic Example

Now we are ready to try an example of basic break-even analysis. Let's assume that you are an entrepreneur engaged in the production of bags. You are preparing your annual plan and that you have to calculate a break-even level for monthly sales. In other words, you must determine the number of bags you needs to sell each month in order to break even. (While this example uses a manufacturing business, remember that break-even analysis can be used for both retail and service businesses as well. A refinement of the analysis for service and retail businesses will follow.)

During this same month last year, you sold 550 bags. Your business has enjoyed moderate growth over the last Year, so you make the reasonable assumption that 600 bags will be sold this month.

Let us also assume that you have projected your income statement, based upon an expected volume of 600 bags per month. Let's also assume that you have classified each monthly expense as either fixed or variable.

This is the classification you have prepared:

Expense Items	Fixed	Variable
Building Rent	200	
Utilities	300	
Telephone	200	
Depreciation	1,000	
Advertising	50	
Insurance	50	
General Office Salaries	400	
General Maintenance	100	200
Direct Materials (Leather, thread, buttons, Zipper, etc.)		10,000
Direct Labor (staff working directly in production)		5,000
Billing Costs		100
Total	2,300	15,300

There are two things to notice about this sample classification of expenses. First, General Office Salaries is included as a fixed cost because in the short run these salaries must be paid regardless of whether any bags are sold or not during the month. Obviously, if the firm fails to sell bags for a number of months, the office salaries will decline and will no longer be considered fixed. This cost would eventually change with the volume of sales. Remember, though, that break-even analysis focuses only on the short run.

Secondly, notice that General Maintenance Expense appears on both the fixed and variable lists. This is because some maintenance costs will be incurred regardless of how many bags we sell (the fixed portion). The office wastepaper baskets will still be emptied, floors washed, and windows cleaned. On the other hand, the more bags we sell, the more the machinery will be used, so the incidence of breakdown is likely to increase, which will require more maintenance (the variable portion).

In the above example, we have divided maintenance as 33 percent fixed and 67 percent variable.

You need just one more piece of information, which is readily available from the business records, before you calculate the break-even point: your selling price. The selling price is known for an existing business. You will find, however, as we will see in a moment, that break-even analysis can actually help you determine your selling price.

Currently, Reliable bags are selling to your dealers for $ 50. Let's summarize what we know so far:

- $ 2,300 = total monthly fixed costs
- $ 15,300 = total monthly variable costs
- $ 50 = selling price for one bag
- 600 = expected number of bags to be sold this month

Here's where we figure Variable Cost Per Unit. Simply divide the Total Variable Cost by the Number of Units we expect to sell to get the Variable Cost Per Unit. An existing business may use a previously calculated variable cost per unit figure, but it is best to review variable costs and expected sales at least annually to assure the most accurate data in doing your break-even analysis. In general, the formula for figuring Variable Cost Per Unit looks like this:

Variable Cost Per unit = Total Variable Costs / Expected Number of Units to be Sold

The calculation for this example looks like this:

Variable Cost per Unit = $ 15,300 / 600 units

Variable Cost per unit = $ 25.50 per unit

Break-Even in Units

You're now ready to calculate the break-even level of sales. We'll let "X" stand for the number of bags needed to break even in the formula. The net sales revenue at the break-even point will be $250 times "X" number of bags. In our formula, then, Net Sales Revenue equals the Selling Price Per Unit times the Number of Units Sold. Similarly, while the Variable Cost Per Unit is $100, the total Variable Costs equal $100 times X number of bags In our formula, Variable Costs equal Variable Cost Per Unit times the Number of Units Sold. Now, simply plug the values we have previously calculated into the break-even formula.

Fixed Costs + Variable costs = Net sales revenue
$ 2,300 + $ 25.50X = $ 50X

And, using a little algebra to solve the equation, we find:

$2,300 = $50X - $25.50X
$2,300 = $24.50X
93.87 = X (Number of units to be sold to Break Even)

Let us check:

Sales 93.87 units x $50	$ 4,693.50
Less: Variable Cost 93.87 units x $ 25.50/unit	2,393.50
Gross Margin	$ 2,300.00
Less: Fixed Cost	$ 2,300.00
Net Income	-
	========

In other words, you need to sell 93.87 or 94 bags during the month just to cover all expected expenses. At the 94 bag point, you will not be making a profit or incurring a loss, but the very next bag you sell will give you a profit.

Break-Even to Set Price

In the above calculation, we assumed the price was set at $50. What happens to our break-even point if we lower the price to $40? Use the formula to find the answer:

Fixed Costs + Variable Costs = Net Sales Revenue

$2,300+ $25.50X = $40X

And, solving as before:

$ 2,300 = $40X - $25.50X
$2,300 = $ 14.50X
158.60 = X

or X = approximately 159 bags

Now, imagine recalculating the break-even point for a whole range of item prices. You would get a corresponding range of break-even points. You can use that range to judge the feasibility of actually reaching different sales levels. If it seems physically impossible to produce the number of units needed to break even at the lowest item price in your range of reasonable prices in the actual marketplace, this is a good advance indication of a potential problem. Possibly, the project is not feasible.

On the other hand, it could be an indication that your classification of expenses is off. You can try adjusting your estimate of fixed expenses to see how that affects your break-even point.

Let's try another illustration of how to adjust estimates. Let's assume the actual fixed maintenance cost is $300. In other words, there is no variable component to this expense item; all maintenance costs are fixed. This might be the case if, for example, Reliable contracted with the machinery manufacturer to provide maintenance on a contract basis. The reason for contract maintenance, of course, is to keep variable costs from increasing beyond acceptable limits. The fixed and variable cost classifications now look like this:

Expense Items	Fixed	Variable
Building Rent	200	
Utilities	300	
Telephone	200	
Depreciation	1,000	
Advertising	50	
Insurance	50	
General Office Salaries	400	
General Maintenance	300	
Direct Materials (Leather, thread, buttons, Zipper, etc.)		10,000
Direct Labor (staff working directly in production)		5,000
Billing Costs		100
Total	2,500	15,100

Therefore, the new variable cost per unit will become:

$15,100 per month / 600 units per month = $ 25.17 per unit.

(This assumes, of course, that there is no change in the number of bags you expect to sell this month.)

How does the change in classification affect break-even? Look at the formula:

Fixed Costs + Variable Costs = Net Sales Revenue
$2,500 + $ 25.17X = $50X

and solving:

$ 2,500 = $50X - $25.17X
$ 2,500 = $ 24.83X
100.68 = X
or X = approximately 101 bags

The new break-even point, as a result of the change in classification of expenses, is calculated to be 101 bags. Notice that we have to produce more than 101 bags to break even and since we only produce whole bags, our break-even point must be 101 bags.

Let us check:

Sales 100.68 units x $50	$ 5,034.00
Less: Variable Cost 100.68 units x $ 25.50/unit	2,567.34
Gross Margin	$ 2,466.66
Less: Fixed Cost	$ 2,500.00
Net Income	-
	========

Note the difference is on the rounding off.

In this case, the change in maintenance expense classification didn't have much impact on the break-even point, since it increased by only seven bags. One could conclude then, if the management felt that seven bags is not a large amount, that the classification of maintenance expense in this case is not as critical to the determination of feasibility as some other expense items.

The main point to take from this series of examples is that the break-even formula is flexible. You can adjust your estimates and classifications to answer a series of "what if' questions - the kind of "what ifs" that frequently come up in business.

There is an important "what if" question we have yet to address. That is "What if I want to find how much I have to sell to make a certain specified profit?" To answer this, we need to make an adjustment to the basic break-even equation.

The Profit Break-Even Formula

Profit is what is left of the net sales revenue after all expenses have been covered. The basic break-even formula identifies the point at which all expenses have been covered, but where profit has not yet begun to accrue. In other words, implicit in the basic formula is the idea that profit is zero at break-even.

In the original example, break-even looked like this:

Fixed Costs + Variable Costs/unit = Net Sales Revenue
$ 2,300 + $25.50 X = $50X

Actually, profit was in the formula, but at a zero value:

Profit + Fixed Costs + Variable Costs =Net Sales Revenue
$0 + $ 2,300 + $ 25.50X = $50X

The general form of the formula above, which we will call the "profit break-even formula", is the form to use when you want to estimate the level of sales necessary to meet a certain profit requirement. Let's look at an example using the same data.

You are requested to find the sales revenue that requires a profit of $15,000 for the period under consideration. How many bags must be sold to make that profit level?

Recall the profit break-even formula and fill in the values we know or have already calculated:

Profit + Fixed Costs + Variable Costs = Net Sales Revenue
$ 10,000 + $ 2,300 + $25.50X = $50X

And solving:

$10,000 + $ 2,300 = $50X - $25.50X
$ 12,300 = $ 24.50X
502 = X

Let us check:

Sales 502 units x $50	$ 25,100.00
Less: Variable Cost 502 units x $ 25.50/unit	12,801.00
Gross Margin	$ 12,299.00
Less: Fixed Cost	$ 2,300.00
Net Income	9,999.00
	=========

Note the difference is on the rounding off.

So, in order to make a $10,000 profit, you must sell 502 bags this month.

As with the basic break-even formula, the real strength of profit break-even is its ability to give you a range of figures to use in your planning.

What if selling 502 bags a month is physically impossible? Suppose you are only able to produce 400 bags a month because d production constraints. **What price would you then have to charge to make a $10,000 profit?**

First, recognize that the variable cost per unit will not change. Therefore, it will still cost $25.50 to produce each chair. Following the procedure we've been, using, the number of bags was always represented by "X" because the quantity of bags was unknown.

Now we know that the number of bags we can produce is 400, and we want to find the sales price. So, let's let "Y" = sales price and fill in the rest of what we know. The profit break-even formula would then look like this:

Profit + Fixed Costs + Variable Costs = Net Sales Revenue
$10,000 + $2,300 + $25.50X = 400Y

And solving:

$10,000 + $2,300 + $25.50(400) = 400Y
$10,000 + $2,300 + $ 10,200 = 400Y
$ 22,500 = 400Y
$ 56.25 = Y

Let us check:

Sales 400 units x $56.25	$ 22,500.00
Less: Variable Cost 400 units x $ 25.50/unit	10,200.00
Gross Margin	$ 12,300.00
Less: Fixed Cost	$ 2,300.00
Net Income	10,000.00
	=========

The above calculation shows that if we must make a $10,000 profit and are only able to make 400 bags in a month, the price that will allow us to meet that goal and stay within our production constraint is $56.25. Obviously, charging anything over $56.25 would insure meeting the profit goal. However, there is a ceiling price above which you will have price out of the market." The market ceiling price is unknown without further market research.

What about Retail and Service Businesses?

So far the discussion has focused on manufacturing. Break-even analysis applies to retail and service businesses also. To adapt the examples in this guide, simply think about the nature of a retail or service business and what you sell.

For example, if you run a retail store, you will still be able to classify your expenses as fixed or variable. Many of the same type of expense items we saw in the manufacturing example also apply to retailers. Items such as utilities, telephone, depreciation, insurance, advertising, and property tax are all examples of fixed costs for retailers. The majority of variable costs for a retailer may be found in the "Cost of Goods Sold" line item on the income statement. Cost of goods sold for a retailer relates directly to costs such as direct materials and direct labor for a manufacturer. Of course, a retailer might also have other variable costs such as billing costs or commissions paid to the sales staff.

You will also be able to calculate a variable cost per unit because you can estimate the number of units you expect to sell. The estimate may be based upon past experience with a particular product or upon projections if you are planning to sell a new product line. Of course, the selling price will also be known or estimated for any of your products.

In a retail business, you are likely to have a variety of products. Break-even is best used on a product-by-product basis. A product-byproduct break-even is more meaningful than a store-wide break-even, because not all items have the same level of profitability. Determine the percent of total sales that each product line represents and use the same procedure to look at price changes, cost changes, or new profit requirements.

If you have a service business, it is likely that you have no tangible "units" to sell. You can still use break-even though. Let's look at an example of how to use break-even in a dressmaking business.

Suppose a dressmaker has itemized her monthly expenses as either fixed or variable, based on the definitions of fixed and variable costs we have used in this article. Suppose the dressmaker identifies the following expenses based on the target of 50 ladies dress completed per month:

Expense Items	Fixed	Variable
Building Rent	100	
Utilities –Power, Light & Water	50	50
Telephone	50	
Depreciation	100	
Advertising	50	
General Maintenance	50	100
Direct Labor (sewer)		500
Materials (thread, needles, buttons etc.)		150
Total	400	800

In this assumption, the dressmaker is paid for the labor of sewing a dress. The customer provides the fabric. The labor fee per unit in this case is $ 30. In this example, the same computation is also applied.

It should be clear that service businesses can benefit from break-even analysis in every way that retail and manufacturing firms do. It simply requires a little deeper thinking about what it is that a service firm sells.

The Last Word: Limitations of Break-Even Analysis

Break-even analysis has four important limitations. First, break-even analysis requires estimated projections of expected sales, fixed costs, variable costs, and any costs that have both fixed and variable characteristics. You must not be lulled into a false sense of security regarding your mathematically-sound results which are, after all, based upon projections.

Second, break-even analysis is useful only over a limited range of sales volume extending not too far from the expected level of sales. Moving much beyond that range will require additional capital expenditures for more floor space, more machinery, or more sales people, which will distort the estimates of fixed and variable costs.

Third, it is generally accepted in basic financial theory that the appropriate way to make investment or capital decisions is to consider the "discounted value of the cash flows" of a proposed project. Such an analysis focuses on the time value of money to better describe the "true" value of an investment. Break-even analysis does not focus on the time value of money. Nor does it focus on opportunity costs. Opportunity costs relate to the best alternative use of your money. There are always alternative uses for funds that may be more profitable than the project or expansion under consideration. Break-even analysis views every project in isolation.

Finally, break-even analysis assumes that the cost-revenue relationship is linear. This may or may not be the case for any particular business. For example, many businesses experience a reduction in fixed and variable costs per unit as the overall scale of the business increases. This is referred to as "economies of scale." Most very small businesses do not experience significant economies of scale.

Despite its limitations, break-even analysis is a very useful tool with which to approach a variety of decision problems. Such questions as the costs of expansion, evaluation of sales or profit performance, estimation of the impact of various expenses on profit, setting prices, and financial analysis in general are appropriately addressed using break-even analysis. But it is not a panacea. It is only one of the many tools available to the decision maker. It is best used in conjunction with other financial analysis techniques or as a screening device to determine whether more study is needed. In any case, familiarity with break-even analysis is essential for any business owner.

TOOLKIT 5
A SAMPLE FEASIBILITY STUDY

1. Name of Member:____Age:___________

2. Single_____Married:_______Educational Attainment:__________________________

3. Type of Enterprise: ____

4. How many months/years you have involved in the proposed enterprise?
   3 months____ 6 months____ 12 months ______ 2 yrs. _______3 years

5. What is your monthly or annual production capacity? Volume ________ and ____________amount.

6. Is it an expansion of an existing enterprise? Yes______________ No_____________
   If yes, what expansion?____

7. If no, specify the purpose of the loan_____________________________________

8. Have you hired manager? Yes _______ No________

9. Part time______Full time:______

10. How many family members support to run the enterprise? ___Are they paid or not?__

11. What is your monthly or annual sale? Volume_________Amount_____________

12. How do you sell? ______Retail ______Wholesale______Agency

13. Do you able to meet your market demand? Yes ______ No______

14. For how much you will sell it ? Wholesale______________ Retail_____________

15. Where the business be located?____

16. If you hire workers, how much will their salary be per day/month/piece?

Type of Work	No. of	Capacity/day	Wage

17. What tools, equipment and machines are needed? Indicate those you already have and those you need to buy.

Need to Buy	**Cost**

Already Have	**Cost**

18. What other overhead expenses will be involved besides the ones mentioned above? Be specific?

Overhead	Cost

19. How much **Working Capital** you need to start or for the existing microenterprise? Refer back to the earlier questions. (Cash you need before your microenterprise generate cash on selling your product):

    Raw Materials ______________________

    Labor Costs ______________________

    Overhead:

    - Utilities ______________________
    - Transportation ______________________
    - Rent ______________________
    - Others ______________________

    Total ______________________

20. What is the Balance Sheet Summary of your enterprise? (latest balance sheet date three months before)

    Cash on Hand and in Bank ______________________

    Accounts Receivable ______________________

    Raw Materials Inventories ______________________

    Finished Goods Inventory ______________________

    Property and Equipment ______________________

    Accounts Payable ______________________

    Loans Payable ______________________

    Owners Equity ______________________

    Retained Earnings ______________________

21. ***Summary of Project Cost***: (this is the total of Working Capital plus equipment or capital asset required to start the enterprise)

	Amount to be Borrowed	Existing Assets	Total Project Cost
Capital Assets:			
Total Capital Assets			
Working Capital:			
Total			

Projected Cash Flow Statement

Particulars	Start of the Enterprise	Year 1	Year 2	Year 3
Cash Received:				
Sales				
Interest Income				
Loan				
Total Cash Received				
Cash Disbursement				
Raw Materials purchased				
Labor costs				
Overhead Costs				
Owner's Drawing				
Utilities (power, light, water)				
Salaries-Administrative				
Marketing				
Repairs and Maintenance				
Other Administrative Costs				
Savings				
Total Cash Disbursement				
Net Cash Balance before loan payment				
Less: Loan payment Principal Interest				
Total Loan Payment				
Net Cash Balance				
Add: Cash Beginning Balance				
Cash Ending Balance				

Projected Balance Sheet

Assets	Start of the Enterprise	Year 1	Year 2	Year 3
Current Assets				
Cash on Hand				
Savings Accounts				
Accounts Receivable				
Inventories (Raw Materials and Finished products)				
Prepayments				
Total Current Assets				
Property and Equipment				
Machines				
Building				
Total Property and Equipment				
Total Assets				
Liabilities				
Accounts Payable				
Loans Payable				
Total Liabilities				
Owner's Capital				
Owner's Capital				
Retained Earnings				
Total Owner's Capital				
Total Liabilities and Capital				

Notes:

1. ***Cash on Hand****-the cash ending balance in the Cash Flow Statement*
2. ***Savings Account****-the cash saved by the member in the credit union*
3. ***Inventory of Raw Materials****-cost of the raw materials on hand at the date of Balance Sheet*
4. ***Inventory of Finished Products****-cost of finished products on hand at the date of Balance Sheet*
5. ***Property and Equipment****-all fixed assets used in the business. This is the fixed assets in the total project cost. The fixed assets is presented in the Balance Sheet net of depreciation*
6. ***Accounts Payable****-any expenses or purchased not paid at the Balance Sheet date i.e. purchase of raw materials on account, wages or salaries not paid, utilities etc.*
7. ***Loans Payable****-the balance of loan receive from the credit union*
8. ***Owner's Capital****-the owner's contribution in the project as indicated in the Total Project Cost*
9. ***Retained Earnings****-accumulated earnings of the business less owner's drawing*

Projected Income Statement

Particulars	Year 1	Year 2	Year 3
Income			
Sales			
Interest Received			
Total Income			
Cost of Good Sold			
Inventory, beginning of Finished Goods			
Add: Cost of Production			
Raw Materials Beginning Balance			
Add: Purchase of Raw Materials			
Less: Inventory of Raw Materials, End			
Total Raw Materials Used			
Direct Labor Costs			
Overhead			
Total Cost of Goods Produced			
Less: Finished Goods Ending Balance			
Total Cost of Goods Sold			
Net Income from Sales			
Operating Expenses			
Salaries-Administrative			
Repairs and Maintenance			
Marketing			
Depreciation			
Other Administrative Costs			
Total Operating Expenses			
Net Profit			

Note:

1. ***Raw Materials*** *- any supplies used in producing the final product.*
2. ***Salaries*** *- fixed amount paid to managerial personnel, usually on a monthly basis.*
3. ***Wages*** *- amounts paid to workers per hour, day or piece work basis.*
4. ***Benefits****-refers to bonus, health care and insurance*
5. ***Depreciation*** *- an accounting method used to charge cost of fixed depreciable assets to operation due to wear and tear over time. The cost of the asset is divided into the estimated useful life and the resulting figure is charged as depreciation expense.*
6. *The cash and non-cash items are calculated to keep track of the performance of the enterprise. The family consumption of the product is valued as well as the labor contributed by the family.*

TOOLKIT 6
RECORD KEEPING IN SMALL BUSINESS

An appropriate record-keeping system can determine the survival or failure of a new business. For that already in business, good record-keeping systems can increase the chances of staying in business and the opportunity to earn larger profits. Complete records will keep you in touch with your business's operations and obligations and help you see problems before they occur.

This toolkit 6 explains the characteristics of and procedure for establishing a good record-keeping system.

The Need for Good Records

Accounting records furnish substantial information about your volume of business, such as how present and prior volumes compare, the amount of cash versus credit sales and the level and status of accounts receivable. In addition, good accounting records help to accomplish the following tasks.

Monitor Inventory

While a large inventory allows goods to be delivered when they are ordered, too large an inventory represents an excess investment. If your inventory does not turn over quickly, your business may lose profits due to obsolescence, deterioration or excess investment.

Any items removed from inventory for personal use should be set aside in a special account for two reasons: first, they need to be recognized separately for tax purposes and, second, including these items in business gross profit calculations can be misleading.

Control Expenses

Accounting records detail the amounts owed to suppliers and other creditors so that you can plan the availability of cash to meet your obligations. Such records also provide information regarding expenditures and allow you to establish controls over them. At all times, you must be aware of your individual expense requirements and how they relate to the overall picture.

Fulfill Payroll Requirements

Payroll is one of the largest expenses in a small business. Adequate payroll records should meet the requirements of the:

1. Internal Revenue Department
2. Local department of revenue
3. Workers' compensation laws
4. Wage and hour laws
5. Social security requirements

For each of these categories you are required to provide annual reports and summaries in the Internal Revenue Department. The department in many countries requires the employer to withhold income taxes to their employees or workers. There is also a law requiring employers to provide coverage on social security and health insurance for their staff part of the law. Thriving business are those that are ethical meaning complying with the rules and regulations set by the government. In order to provide this detailed information, it is essential for you to maintain good accounting records.

Determine Profit Margin

Good accounting records will indicate a business's level of profit, and provide specific information on the profitability of certain departments or lines of goods within your business. Such analysis is important to avoid continuing product lines far beyond their profitability. In most cases, you can avoid losses if you maintain current records and analyze the information from, your records on an ongoing basis.

Improve Cash Flow

Good accounting records provide detailed reports of cash availability, both on hand and in the bank, and of cash shortages or the diversion of cash. Since cash is your most liquid asset, you must carefully account for it.

Measure Performance

Finally, good business records help you measure your business's performance by comparing your actual results with the figures in your budget and those of other similar businesses.

Requirements of A Good System

The following criteria are essential to a good record-keeping system:

1. Simplicity
2. Accuracy
3. Timeliness
4. Consistency
5. Understandability
6. Reliability and completeness

There are several copyrighted accounting systems that can be purchased and adapted to the individual business, or you may find it is better to use a system specifically designed for your business and one that meets the above-mentioned criteria.

Commercial Record-Keeping Systems

Record-keeping systems are currently available from various sources in the marketplace: stationery stores, publishers and business advisory services. These systems either are specifically designed for a certain type of business or are general enough to be used by many different types of businesses. Systems are available for cash basis recording, accrual basis recording and for both single and double entry.

Computerized Record Keeping

If you have expanded your business, consider using a computer for your business operations. Compare different software systems and make sure that the system you choose provides accurate and timely information and offers more than adequate presentation of accounting information for small businesses.

Low-cost computer programs are available that can handle many of the book entries that are necessary in a system that is maintained by hand. Appropriate hardware and a good general ledger software program can offer you substantial assistance in recording business transactions and summarizing the information into appropriate accounting presentations.

Currently available software allows you to enter transactions individually; these transactions are posted directly to the general ledger. A printout at the end of a given period shows the individual account activity, and also includes balance and total of the accounts and provides a trial balance presentation. If the software is designed properly, it will provide appropriately prepared financial statements (balance sheet, income statements).

Methods of Accounting

There are two basic methods of accounting: cash basis and accrual basis. 'Me method you choose will depend on your type of business. Cash basis is the simpler method. It is mainly used by service businesses that do not maintain inventory or startup businesses that do not offer credit. The accrual method is used by businesses that provide for credit sales or maintain an inventory.

Cash Basis Method

In cash basis accounting, you record sales when cash is received and expenses when they are actually paid. Using the cash basis method is like maintaining a checkbook. Under this method, accounts receivable are not recorded as Wes until they are collected. Accounts payable are not recorded as expenses until the account is paid. Bad debt, accruals and deferrals are not appropriately recorded under cash basis because they are examples of outstanding credit (business notes). The cash basis method is not appropriate for businesses that extend credit.

Accrual Basis Method

In accrual basis accounting, you report income or expenses as they are earned or incurred rather than when they are collected or paid. Record credit sales as accounts receivable that have not yet been collected.

The accrual basis also provides a method for recording expenditures paid in a single installment but covering more than one period. For example, interest may be paid semiannually or annually, but it is recorded on a monthly basis.

The accrual method satisfies the matching concept, i.e., matching income with related expenditures. Consequently, it can provide a clear and accurate view of business operations for a given period.

The Accounting Cycle

The accounting cycle can be described as follows:

1. A business transaction occurs; giving rise to an original document that is recorded in a book of original entries called a journal.
2. The totals from the journal are summarized and reported in a book of accounts, known as a general ledger.
3. The general ledger contains the individual accounts maintained by the business.
4. The individual accounts are listed in the form of debits and credits, known as the trial balance of the general ledger.
5. From this trial balance, after making certain adjustments, you prepare the business's financial statements.

Journals

You derive the information for each journal entry from original source documents, such as, sales slips, cash register tapes, check stubs, purchase invoices and other items that record your business transactions. You may need to create subsidiary journals for specific, frequently occurring types of transactions, such as sales and expenses.

General Ledgers

The summary and totals from all journals are entered into the general ledger. A general ledger is a summary book that records transactions and balances of individual accounts, and is organized into five classes of individual accounts, as follows:

1. Assets-A record of all items that the business owns.

2. Liabilities-A record of all debts the business owes.

3. Capital-A record of all ownership or equity.

4. Sales-A record of all income earned for a specific period.

5. Expenses-A record of all expenditures incurred during a given period.

When the trial balance is prepared, these classifications are easily recognized.

Trial Balance

At the end of the fiscal year or accounting period, the individual accounts in the general ledger are totaled and closed. The balances of the individual accounts are summarized in the financial statements.

Financial Statements

The main types of financial statements are the balance sheet and the income statement, also known as the profit and loss statement. The balance sheet is a report of a business's financial condition (assets, liabilities and capital) at a specific moment in time (see Example 1) and the income statement is a summary of profit and loss for a specific period of time, generally a month, quarter or year (see Example 2).

Other statements may be prepared. For example, a cash flow statement identifies the sources and applications of cash. Statements may also be prepared to indicate manufacturing expenses or other special areas that are of interest to you.

Example 1

ABC SALES CO.
BALANCE SHEET
December 31, 20_

Assets			
Current assets			
Cash		$23,590	
Notes receivable		10,000	
Accounts receivable		83,030	
Store supplies		1,440	
Prepaid insurance		1,650	
Total Current Assets			**$119,710**
Property and Equipment			
Land		$20,000	
Building	$140,000		
Less accumulated depreciation	33,900	106,100	
Office equipment	15,570		
Less accumulated depreciation	8,720	6,850	
Store equipment	27,100		
Less accumulated depreciation	15,700	11,400	
Total property and Equipment		**144,350**	
Total assets			**$264,060**
Liabilities			
Current liabilities			
Accounts Payable		$23,572	
Mortgage note payable (current portion)		5,000	
Total current liabilities			**$28,572**
Long-term liabilities			
Mortgage note payable		20,000	
Total liabilities			**$48,572**
Stockholders' Equity			
Capital Stock		$100,000	
Retained earnings		115,488	
Total stockholders' equity			**$215,488**
Total liabilities and stockholders' equity			**$264,060**

Example 2

ABC SALES CO.
INCOME STATEMENT
December 31, 20____

Revenue from Sales			
Sales			$732,163
Less: Sales returns and allowances		$6,140	
Sales discount		5,822	11,962
Net sales			720,201
Cost of merchandise			
Merchandise inventory, January 1, purchases		530,280	
Less purchases discount		2,525	
Net purchases			527,755
Merchandise available for sale		587,455	
Less merchandise inventory, December		62,150	
Cost of merchandise sold			525,305
Gross Profit			194,896
Operating Expenses			
Selling expenses			
Sales salaries	$60,044		
Advertising	10,460		
Depreciation-store equipment	3,100		
Insurance-selling	2,080		
Store supplies	2,010		
Miscellaneous (selling)	630		
Total selling expenses	78,324		
General expenses			
Office salaries	21,032		
Heating and lighting	8,100		

Taxes	6,810		
Depreciation-building	4,500		
Depreciation-office equipment	1,490		
Insurance-general	830		
Office supplies	610		
Miscellaneous	760		
Total general expenses		44,132	
Total operating expenses		122,456	
Net income from operations			72,440
Other Income-interest income		3,600	
Other expense-interest expense	2,440	1,160	
Net Income			73,600

How to Analyze Your Records

To chart the progress of your business, you should become familiar with various forms of financial statements analysis and measurement.

Financial statements indicate which items need more attention. For example, profits may be too low or rent unnecessarily high. Perhaps there is a way to use the business vehicles more efficiently, to increase inventory turnover or to reduce long distance telephone bills.

In analyzing financial statements, carefully examine all items that do not seem realistic. Answer the following questions:

- Why are certain expenses at a particular level?
- Are there any ways to reduce or avoid certain expenses?
- Should you incur all of your expenses?
- Does the level of profit justify your investment, time and effort?

Financially significant items should be analyzed regularly. For example, examine payroll as a percentage of total administrative expenses. Keep in mind that, if your business is a proprietorship, your salary is not a payroll expense; however, if your business is a corporation, your salary should be a payroll expense.

Analyzing Payroll Expenses

In justifying payroll and other expenses, answer the following questions:

- Are accurate records maintained for time spent on various jobs and functions?
- Is the eight-hour day of each employee accounted for appropriately?

- When employees are paid overtime, is the additional expense reflected in charges to the customer?
- Is the level of payroll expense appropriate for your type of business?
- Are you billing on a guaranteed price basis or on an hourly basis?
- When using guaranteed price basis for billing, does actual time spent exceed time estimated for the job?
- Do employees work with a minimum of wasted effort and time?
- Are you operating at maximum efficiency? What strategies can be implemented to maximize efficiency?

Other Important Factors

In addition to accounting records, you will need to keep separate records for accounts receivable, payroll and taxes, petty cash, insurance, business equipment and perhaps other items.

A good record-keeping system should provide you with a detailed report of accounts receivable, including current information on customers and a running balance of their accounts. To maintain a good accounts receivable system, record credit charges on a regular basis. It is essential that you follow up on all late paying and delinquent customers.

Accounts receivable should be aged at the end of each month. This means organizing the accounts into those that are current; 30-, 60-, and 90-days old and older. This arrangement helps you to take appropriate, timely actions.

One example of a timely action is to transfer delinquent accounts to a notes receivable account. Notes receivable are loans the business makes to others, either inside or outside the business. Each note receivable should contain specific terms of credit and interest and should be signed by the customer. An additional timely action to decrease the number of bad accounts and avoid the effort of collecting payments from slow-paying customers is to issue a formal complaint with your local credit bureau.

Petty Cash

Sometimes a petty cash fund is needed to purchase small items required on a day-to-day basis. If this is necessary, draw a check to petty cash for a nominal amount.

Problems often arise when cash is easily available; therefore, if possible, avoid a petty cash fund. However, very often the convenience of having a small amount of cash available will facilitate the smooth operation of your business. Be sure to balance this fund monthly, based on the cash balance plus receipts for all expenditures.

Insurance

Most businesses have several types of insurance. For each policy, you should have the following information:

- Clear statement of the type of coverage.
- Names of individuals covered.
- Effective dates and expiration date.
- Annual premium.

Review your insurance policies on a regular basis. In addition, annually consult an insurance specialist, who will review the total insurance package to determine what coverage is appropriate and ensure that premiums remain in line with prior quotations.

Business Equipment

Keep an accurate list of permanent business equipment used on both a regular and stand-by basis. The list should describe the equipment and provide serial numbers, date of purchase and original cost. Keep the list available for insurance or other purposes. You will also need this information to prepare accurate depreciation schedules.

Accounting Services

You have several choices in who should maintain your accounting system. You can

- Maintain the books yourself.
- Hire a bookkeeper on a full-time or part-time basis.
- Hire the accountant who set up your books.

Set up a hybrid system in which you maintain the day-to-day reports, while an accountant does the period-end record preparation, summaries and reconciliations and the returns for sales tax, excise tax and payroll taxes.

In making the choice, you must decide whether you have the ability and time to set up and maintain good records or if you should engage an outside accounting service. It is usually suggested that you hire an accountant to do the final year-end preparations and to advise you. No matter what you choose, you should remain familiar with your books and participate in the record-keeping process. This will maximize the services provided by the accountant and allow you to keep track of your business.

When selecting an accountant, the cost of the accountant's fees must be weighed against the benefits received. Frequently, the accountant's professional advice can increase profits to more than cover the expense. Monthly services by an accounting firm will provide you with complete and timely information and also will allow the accountant to develop knowledge of your business and be in a more comfortable position to render professional advice as the business grows.

In addition to bookkeeping, an accountant can advise you on financial management he or she can assist with cash flow requirements and budget forecasts, business borrowing, choosing a legal structure for your business and preparation and advice on tax matters.

Cash Flow Requirements

An accountant can help you work out the amount of cash needed to operate the business during a certain period-for example, a three-month, six-month or one-year projection. The accountant considers how much cash you will need to carry your accounts receivable, to increase inventory, to cover current invoices, to acquire needed equipment and to retire outstanding debts. Additionally, the accountant can determine how much cash will come from collection of accounts receivable and how much will have to be borrowed or provided from other sources.

In determining cash requirements, the accountant may notice and call attention to danger spots, such as accounts that are in arrears or delinquent areas or areas of excess expenditure.

Business Borrowing

An accountant can assist you in compiling the information necessary to secure a loan: the assets the business will offer for collateral, the present debt obligations, a summary of how the money will be used and repayment schedules. Such data show the lender the financial condition of the business and your ability to repay the loan. Remember, lenders have two very definite requirements: (1) that the business has adequate collateral to secure the loan and (2) that the business will be able to repay the loan. An accountant can advise on whether you need a short- or long-term loan. In addition, your accountant may introduce you to a banker who knows and respects his or her financial judgment.

Appendix B

Sample Forms

Business Plan Format

GOAL AND STRATEGY SETTING

Follow the SMART Rule: 1) Stretching-they should challenge the manager and the team;
2) Measurable-they must be quantifiable; 3) Achievable-they must be realistic;
4) Related to Members/Customers-they should improve the services to them; and 5) Time-targeted-they must have an end date.

Goals for the next 3 years Action + Measure + Time	*Strategies* How will you achieve your goals? There are many options to achieve the goals. You need to select from those options. Criteria should be: Cost Effective, innovative, and not routine.
Goal 1:	
Goal 2:	
Goal 3:	
Goal 4:	
Goal 5:	

ACTION PLAN

Teams must take strategic plan seriously. Use the discipline of clear documentation.

Strategy No. ________:			
Measure: ***(the achievement of the goal)***			
Deadline:		**Owner:** **(the person with overall responsibility for achieving the goal)**	
Actions *An event or achievement marking the progress related to the strategy*	**Responsible** *Person responsible for the action*	**Time** *Date for which action should be completed*	**Milestones** *(Key events that allow you to monitor if the action is on track to finish in time)*

Note: copy this page for the other strategies

PROPOSED BUDGET OF INCOME AND EXPENSES

Particulars	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Total
Projected Income					
Consulting Fees					
Sales of Products					
Training Fees					
Sales of Publications					
Total Income					
Operating Expenses:					
Salaries of BDC Staff					
Cost of Publications					
Product Purchases					
Training Costs					
Research and Development					
Administration costs					
Total Operating Expenses					
Net Income (Loss) from Operations					