HOW TO START A BUSINESS

A Guide for Georgia Entrepreneurs

Small Business Development Center
UNIVERSITY OF GEORGIA
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CHAPTER ONE: ENTREPRENEURSHIP

Before Starting a Business

Deciding whether or not to start a new business can be one of the most difficult decisions a person faces in life. The consequences are widespread, the impact is deep, and the required commitment is immeasurable. People arrive at this crossroad from various points. Some people seem to be "born entrepreneurs." These are the people who as youngsters ran the lemonade stand, delivered newspapers, baby-sat the neighborhood children, or cut the neighbors' lawns. The desire to be their own boss or control their own destiny seems to be in their blood, and no one is surprised when they drop out of college because their side business has become so prosperous.

Other people arrive at the crossroad less out of their own choosing. An existing employment situation may have become intolerable, or the employer may be downsizing, rightsizing, or simply going under. There is also a new breed of entrepreneurs, called *lifestyle entrepreneurs*. Lifestyle entrepreneurs may include early retirees or others with strong philanthropic or personal objectives that seek entrepreneurship as a strategy for obtaining multiple goals. Thus, the time has come. A decision must be made: jump back in the rat race or strike out on your own. It's a tough choice, but many people face it every day.

In the first section of this guidebook, a series of issues will be presented that will aid in this important decision making process. Persons who complete this initial assessment will be more confident about their final decision. Entrepreneurship is not for everyone. Success depends not only on personal ambitions and means, but also on external factors beyond a person's realm of control. Therefore, a thorough analysis of the internal factors will help to minimize the risks inherent in this decision. These internal factors (personal strengths and weaknesses) can then be compared to the typical expectations of an entrepreneur forcing a Go/No Go decision. If a Go decision is reached, the next step is to examine the feasibility of the proposed business. The business feasibility determination is based on whether or not the business can meet the entrepreneur's short-term and long-term goals.

Self Assessment

An honest evaluation of aptitudes and attitudes will help determine whether or not entrepreneurship is an appropriate career move. Sometimes the risks simply outweigh the rewards, and it is important to make this determination prior to cashing in the 401k, diluting the kids' college funds, or maxing out a few credit cards. Below is a series of questions from various sources worthy of serious consideration. There are no right or wrong answers and no scoring. The only requirement is sincerity resulting from a balance of logical thinking and gut feelings. Recording the responses is recommended, in order to compare this personal reflection to the expectations of an entrepreneur.

SELF ASSESSMENT

QUESTIONS TO ANSWER BEFORE STARTING A BUSINESS

- Are you courageous? Do you have a tendency to take calculated risks?
- Are you self-motivated? Are you self-confident?
- Do you have thick skin? Can you accept advice from others?
- Do you enjoy competition?
- How well do you manage money?
- Are you able to make plans? Do you carry out your plans? Do you do so in a timely manner?
- How well do you make decisions? Do you prefer to be in charge?
- Do you have pertinent industry experience or transferable skills?
- How would you rate your personal skills in the following areas: Oral presentations? Written communications? Computer skills? Word processing and other relevant software? Organizational skills?
- How would you rate your business skills in the following areas: Sales and marketing? Financial planning? Accounting? Administrative? Personnel? General management?
- What do you want to achieve through owning a business? What are your personal goals? Financial goals? Service goals?
- How well do you adapt to changing conditions?
- Do you mind working long hours for six or seven days per week and possibly holidays?
- Do you have the emotional and conceivable financial support of your family in this endeavor? Would you mind lowering your standard of living for several months or even years? Are you prepared to lose your savings?
- Do you have the physical endurance to handle owning and running a new business?
- Do you have the emotional fortitude to handle the stress of owning and running a new business? Can you persevere? Do you have will power and self-discipline?
- Do you work well alone?
- How well do you work with and manage others?
- Do you have the ability to devise new and innovative ways of doing things?

Self Assessment

QUESTIONS TO ANSWER BEFORE STARTING A BUSINESS (Continued)

- Are you able to use defeats and obstacles constructively by turning them into useful lessons for the future?

Sources: Strengths and Weaknesses Checklist, *Small Business Tools*. CCH, Inc. Obtained September, 2002 from http://www.toolkit.cch.com; 10 Things You Need to Know About Yourself Before You Start A Home Business, *Home Business Start Up Help*. K.S. Lewis Publishing. Obtained September, 2002 from http://www.newworkplace.com; "Can You Make Money with Your Business Idea?" The Small Business Knowledge Base. BizMove.com. Obtained September, 2002 from http://www.liraz.com.

Expectations of an Entrepreneur

Considerable research has been conducted to define the personality of an entrepreneur. A family history of entrepreneurship, educational attainment, propensity for risk taking, and optimism are but a few of the characteristics that have been examined. While there are some central tendencies, there does not appear to be a specific formula for success. And, in fact, many business experts agree that sometimes all it takes is a little bit of luck to instigate success. The following list presents some points to consider. It is important to bear in mind that possession of all of these traits does not guarantee a successful business venture, nor does the absence of one or two traits indicate certain failure. There are ways to shore up one's weaknesses that will be discussed later.

Critical Success Factors for New Business Owners

- Willingness to Sacrifice
- Strong Interpersonal Skills
- Strong Leadership Skills
- Strong Organizational Skills
- Intelligence/Common Sense
- Management Ability
- Business Experience
- Optimism

Source: "Essential Qualities for Owners," Small Business Guide. Retrieved May, 2006 from http://www.toolkit.cch.com/text/P01_0470.asp.

Expectations of an Entrepreneur

When comparing the internal assessment to the expectations of an entrepreneur, some patterns begin to form. The decision may not be completely self-evident at first. Other factors not included here could influence the Go/No-Go decision and should be considered as well. Also, you should examine the situation from both sides: Do you have the skills, traits, and assets to own and operate a business? And does the business concept capitalize on your abilities and ambitions? Just like pieces of a puzzle, the characteristics of the potential owner and the critical success factors of the business should mesh well. Take all of this into account when making your final decision.

In his book, *The E-Myth Revisited: Why Most Small Businesses Don't Work and What to Do About It*, author Michael Gerber describes the ultimate business owner as three distinct "personalities:" the entrepreneur, the manager, and the technician. The entrepreneur is the visionary, the manager is the systems designer, and the technician is the doer. Gerber claims that most new business owners are frustrated technicians, who love what they do and are good at what they do, but don't want to do it for someone else. Unfortunately, without the other personalities, the technician becomes even more frustrated because owning a business is more than working *in* the business—it means working *on* the business, too. The manager is needed to create order and the entrepreneur is needed to keep the business innovative. If you are still uncertain whether business ownership is the right decision, a quick read of this book might prove helpful.

If there appear to be some gaps between individual characteristics and the expectations, then a potential business owner should take steps to narrow the gaps. One possible solution is to utilize the skills of another person. Join forces with a partner or hire a person to handle some of the responsibilities. Outsourcing certain functions such as payroll, computer maintenance services, collections, and advertising may be viable options. Of course, at some point nearly every business must seek the advice of an accountant and an attorney (although some entrepreneurs make the mistake of calling on these professionals too often during the start-up phase, thereby inflating the initial expenses of the business). Another solution is to take advantage of business education classes and the multitude of various print and web-based training materials. The UGA SBDC offers hundreds of business training classes covering accounting principles, marketing on a shoestring budget, and how to hire and fire employees, to name a few. These classes are very affordable and can better prepare the entrepreneur for the upcoming challenges of business ownership.

The Business

Once you have determined that you have what it takes to own and operate a new business, you must examine the business itself. What specific goals are you seeking? Will this business venture enable you to reach them? In other words, why is this business concept under consideration and what do you hope to gain from it? Fame? Fortune? Happiness? All of the above?

By setting some broad short-term and long-term goals for the business, you can begin a rough analysis of the business concept. These goals should be realistic and measurable within a specific period of time. Experts often suggest that short-term goals are beneficial for psychological reasons, since revenues usually lag efforts and profits lag revenues. Some examples of short-term goals might include obtaining proper permits or licenses, purchasing equipment or inventory, and registering a domain name.

Long-term business goals might include revenue or profit levels, recognition as an industry leader, and the eventual sale of the business. Long-term personal goals might include flexible scheduling, professional development, and adequately providing for one's family. These goals form the building blocks for a business plan that will outline the structure and operations of the business.

With these goals in mind, one can conduct a feasibility study of the business concept. There are two main components to a feasibility study: the marketing feasibility and the financial feasibility. The marketing feasibility determines whether or not there is sufficient demand for your products or services. Is it a good idea? At this time? In this place? For this price? The financial feasibility determines whether or not there is profit potential with this business concept. Will projected sales cover your projected expenses? And if so, when? Will this margin be enough for you to make a living?

In some instances there will be a third component of the feasibility study: the technical feasibility. For new products and services this is an essential step. Can the "widget" be manufactured with some new and unique features that consumers desire? Are the logistics in place to offer a web-based ordering system? Do patents or trademarks apply?

The next two chapters of this guidebook will illustrate how to determine marketing feasibility and financial feasibility. Once you establish the feasibility of the business idea, you can prepare a business plan using the goals discussed above and the information collected in the feasibility assessment. Business plans are often referred to as blueprints that guide the actions of a business. They are also a requirement of nearly any supplemental funding source.

The Business

Following the chapters on feasibility determination and business plan development are chapters discussing bookkeeping, legal and insurance issues, and long-term management considerations. While this book outlines the basic principles of entrepreneurship, there are numerous additional resources in print and on line that are listed in the Appendices. In-depth advice and assistance are available through the UGA SBDC. Visit our web site at www.sbdc.uga.edu to view dates and locations for training opportunities or to contact one of our business consultants for specific guidance.

www.georgiasbdc.org

CHAPTER TWO: MARKET FEASIBILITY

Of the three tests for new business feasibility (marketing, financial, and technical), marketing feasibility is arguably considered the most critical test. If there is no market demand, then there is no point in evaluating the financial or technical feasibility. If there is a market of substantial volume, then the financial feasibility and technical feasibility need to be carefully examined to determine if this market can be profitably served. There are three main questions, the answers to which determine marketing feasibility:

- Who makes up the target market and how large is the potential customer base?
- Who are the competitors and how does your product/service compare to theirs?
- How much of the market can you expect to capture?

By researching the target market, analyzing the competition, and determining appropriate product positioning, you will be well on the way to developing a marketing strategy. All of this information will help you estimate the potential sales of your new business. The potential sales figures will be used in developing your projected financial statements.

Types of Research

SECONDARY MARKET RESEARCH

Secondary market research can be helpful when analyzing a broad issue or topic. The U.S. Census Bureau is one of the most popular sources of secondary data. Many secondary market research studies and publications are available through the Internet; however, some directories and indexes are available in print only and can be found at most public libraries. Included in this chapter are two instructional tables outlining secondary sources of information for industry profiles and for specific firms (competitors).

PRIMARY MARKET RESEARCH

Primary market research is undertaken with a particular objective in mind. Data is gathered either by someone who has been hired to collect information or by you. Primary data collection can be as formal as mail surveys, telephone interviews, or focus groups or as informal as directly observing shopping habits and spending patterns. Some examples of primary research activities might include:

- looking at a competitor's advertisements to see what a store is charging for products
- observing license tags of cars in the competition's parking lot (to identify from what counties customers are coming)
- interviewing business owners that operate similar stores
- mystery shopping (entering a retail establishment as a customer to learn as much as possible about the business)

Types of Research

Surveys

If a survey is called for, then you must decide what you need to know, whom should be surveyed, how many people to survey, and the best way to reach your targeted participants. A questionnaire should cover interest and need for the product or service; demographic and lifestyle information about the prospective customer; the best way to reach the target market when advertising; where customers shop or who they buy from; and acceptable prices for your proposed product or service. Possible methods of conducting the survey include direct mail; telephone interviews; personal interviews at shopping centers, trade fairs, and community events; interviews with groups such as local clubs and organizations; and an informal survey on Facebook, Twitter, or other social media outlet. View the results of the surveys objectively to determine a course of action. Assistance with survey design, administration, and reporting is available from the UGA SBDC. (Note: Fees apply for all out-of-pocket costs.) Sample feasibility surveys are contained in the Appendix.

Focus Groups

Focus groups can be helpful when one needs qualitative information. This methodology is particularly useful in new product or service development. For example, potential customer input can aid in the design process (importance of various attributes), identify perceived customer benefits, and determine acceptable pricing for various product features (customer benefits). Focus groups generally consist of eight to twelve persons along with a trained moderator. It is important to conduct more than one focus group in order to avoid *group think*, which can occur if one or two persons dominate the discussion to the point that the other participants merely follow their lead. There are numerous focus group facilities in Atlanta and in most of the other metropolitan areas in Georgia. These facilities will recruit participants and often provide a moderator, who will write a report summarizing the findings of the discussion. Moderating and report writing services are also available through the Applied Research Division of the UGA SBDC. (Note: Fees apply for all out-of-pocket costs.)

Target Markets

Too often, potential business owners are so enamored with their idea for a new business that when asked who their potential customers are, they say “everybody!” When you have what you believe is a great product or service, it is easy to fall into the trap of assuming that everyone will want to be a customer. This attitude can lead to the costly and ineffective practice of *shotgun marketing*: trying to reach and sell to everyone by using general, widespread, nonintegrated marketing tactics. For example, the body piercing specialist is not likely to be successful if he assumes everyone wants body piercing and advertises only in the local town newspaper typically read by middle-aged to older adults.

Target Markets

One cannot assume that a business will succeed without determining who comprises the target market and whether or not this market is of sufficient size to generate the sales needed to sustain the business. It will be a waste of time and money to simply assume there is a huge, eager market for the business and then try to market your product or service to everybody.

Determining whether or not a sufficient market exists for your new business and gaining the most benefit from your marketing efforts requires segmenting your market of potential buyers. There are several methods of segmentation from which to choose, and the choice may vary according to the product or service being sold and whether the buyers are individual consumers or other businesses ("business to business" sales, abbreviated "B2B"). The most common methods are based on customer purchase behavior or product usage. Some initial market research will help any entrepreneur determine which segmentation variables have the most impact on purchase behavior and/or product usage and ultimately which segments are the most lucrative for a particular business.

Consumer Markets		**Business Markets**	
Segmentation Variable	For Example...	Segmentation Variable	For Example...
Geography	-Region -Urban/Rural -Climate	Geography	-Sales Territories
Demographics	-Age -Gender -Family Life Cycle -Income -Occupation	Demographics	-# of Employees -Revenues -Industry
Psychographics	-Values -Attitudes -Lifestyle -Opinions -Personality	Personnel	-Department -Opinion Leaders -Decision Makers
Behavior	-Frequency of Use -Frequency of Purchase -Method of Use -Method of Purchase -Brand Loyalty -Price Sensitivity -Benefits Sought -Purchase Occasion	Behavior	-Frequency of Use -Frequency of Purchase -Method of Use -Method of Purchase -Supplier Loyalty -Price Sensitivity -Benefits Sought -Purchase Occasion

Target Markets

For example, a restaurant might select any of the following segmentation strategies in order to define its target markets:

Demographics: singles/young families/empty nesters/mature consumers

Psychographics: trend setters who seek a certain ambiance/health conscious who seek nutritious offerings/budget minded who want a good value/folks on the go who are convenience-oriented

Behavior: mealtime/frequent patrons/activity-based (after the theater, before the game, on the way to the beach, etc.)/special occasions (birthdays, anniversaries, showers, proms, holidays, etc.)

Once the target markets have been defined, the entrepreneur can begin to review the competition to see how other businesses appeal to the customers and to see if there are any gaps or niches in the marketplace that a new product or service could profitably fill. If there do not appear to be any viable gaps, then the segmentation strategy should be reevaluated to see if other opportunities exist through other target markets.

Three caveats should be considered when conducting market segmentation analysis:

- The market is dynamic; therefore, a segment that is viable today may not be viable next year (or next month depending on the specific circumstances). The importance of tracking customer trends cannot be overstated.
- An ill-segmented market is nearly as dangerous as a mass market approach. The objective of defining target markets is to improve efficiency, but if you totally miss the mark, any savings due to efficiency are lost.
- Do not put all your eggs in one basket. If one target market goes sour, additional secondary target markets should be pursued.

When new business owners begin to see the importance of demographic and psychographic market information, many wonder “How could I possibly know these things about my potential customers?” Much of this information may be obtained through reviewing existing research material (secondary research) or by conducting surveys (primary research). Both methods of obtaining information should be explored.

Target Markets

After determining your target market, its size, and its characteristics, you should analyze the competition to determine whether or not you can expect to capture a large enough portion of the market to make your new business a success. Competitor information should help differentiate your business from the competition, that is, what position your business will hold in the marketplace vis-à-vis other providers.

Analyzing the Competition and the Industry

THE COMPETITION

It is dangerous to assume there is no competition. While researching the planned location may reveal that there is no other business like yours, this fact does not mean your potential customers have no choices.

The best approach to competitive analysis is to ask, "What are my customers' alternatives to buying from me?" This approach suggests that the target customers, their wants, and their alternative resources are known. Then you can plan how to persuade potential customers to buy from you instead of from the competition.

An example would be a person who decides to open a store specializing in selling Italian ice because no one in the area sells this product. If the entrepreneur assumes this gap in the marketplace means there is no competition, then the entrepreneur is ignoring the fact that potential customers have other options (direct competitors versus indirect competitors). The customer is not looking for Italian ice per se; the customer is looking for a cold, tasty, affordable treat. The business owner must convince the prospective customer to buy Italian ice instead of choosing alternatives such as ice cream, popsicles, snow cones, or buying a cold treat from a grocery store. Thinking of competition in this way underscores the importance of conducting some evaluation of the competition before deciding how to market and differentiate the product. A quick sweep of the Internet using key words to search out potential competitors is a good beginning to finding out who your most well-known or tech savvy competitors are.

Once the customers' alternatives have been fully identified, evaluating the competition can be as simple as shopping the competition (mystery shopping). The aspects of the competition to be observed — such as product quality, variety of products, hours of operation, pricing, promotional displays, store policies, customer service, the number and types of employees — should be determined ahead of the visits and/or phone calls. Competition should be observed through several visits over time to determine how and when changes are made. Observing the change in store traffic during the day, from day to day, and even month to month is important. It may be useful to develop survey forms and ask trusted friends and relatives to assist with the visits. These types of mystery shopping forms as well as assistance with this type of data collection and analysis are available from the UGA SBDC.

Analyzing the Competition and the Industry

Acquiring Information About "The Competition"	
Action (how to do this)	Means
Identify businesses that sell products/services similar to what you want to provide: Use an online mapping application or directory	www.google.com/maps is a quick and easy tool to locate competitors near your targeted location. For example, if opening a restaurant, you can set your targeted location and then search for "restaurants near me." You can then scroll away from your location in all directions to see an inventory of restaurants "near you."
Identify the size of the firms and the amount of their sales: What are estimated sales? Does this business have a web site? How many employees does the business have? How long has the business been in business? Who is the owner/manager?	Your local UGA SBDC office has access to the Reference USA database. This database of U.S. businesses is updated quarterly, contains estimated annual sales, the number of employees, the year the business started, as well as contact information (manager or owner, address, and telephone number). Many local libraries also provide access to this database for library card holders. Annual reports and 5K reports from publicly traded companies are available at most public and university libraries.
Identify features of their products/services: Visit the competitor's business and look around. What products do they offer?	Observe the business. What products do they offer? What works well in the business and what needs to be improved? Why do people buy from them?
Analyze their location(s): Conduct a "windshield survey." Obtain traffic counts.	Drive past the business. What is your first impression? Is there something on the outside of the business that would draw in customers? What is the "curb appeal" of this business? Is the business located on a major road? What is the traffic flow at this location? Does adequate parking exist? The Georgia Department of Transportation has an online resource, http://geocounts.com/gdot/, that allows you to search for traffic counts near addresses and at intersections. Your local UGA SBDC office also has access to *esri*, a database that can provide traffic counts within a specified radius of your targeted location.
Determine the competitiveness of their pricing: Telephone or visit the business to inquire about the pricing for specific products.	After identifying the competitors, one might compare the prices for specific products/services. Does the pricing seem reasonable for the quality and the service provided?

Analyzing the Competition and the Industry

Acquiring Information About "The Competition" (Continued)	
Action (how to do this)	Means
Define their reputation/image: Look at advertisements, storefronts, logos, brochures, sales kits, press releases, web sites, etc.	Internal analysis: What image does this company project? Is this company concerned about quality and service? What impression do the advertisements convey about the business? How do people describe this firm?
Evaluate the marketing strategy: Based on all the information collected, determine what seems to be each competitor's ultimate goal. What market position are they seeking and have they been successful?	Synthesize secondary data collected; primary research of marketplace can help define purchase behavior and benefits delivered by various firms.

An evaluation of the competition should reveal the competition's strengths and weaknesses in relation to the wants and needs of your target market. Learning from the competition's strengths can help you improve your product or service, your marketing strategy, and your overall business management. The competition's weaknesses can be opportunities for differentiation. Promotional strategies can be devised to highlight your business's differences from the competition, but make certain that the differences are relevant to your target market.

For example, someone planning to open a daycare center may discover that none of the nearby centers offer transportation services for after school care. There may be parents in the area who would like to have transportation for the child from school to the center each afternoon. Perhaps these parents have work schedules that make it difficult for them to drop off children at the center. The new business owner should consider the benefits (and costs) of adding a transportation service to the new center's available services in order to attract these clients. The benefits of this added feature could become an important selling tool in the business owner's efforts to promote the business resulting in a competitive advantage.

THE INDUSTRY

Industry research can be as important, if not more important, than your local competition research. What are the overall trends in the industry? How are social, political, environmental, technological, and economic forces impacting the industry? How are competitors reacting to these forces and how will your new firm be impacted? These questions can be answered by studying secondary data. Your responses to these industry conditions will be the basis for your company's marketing strategy which will be further discussed later in this chapter.

ANALYZING THE COMPETITION AND THE INDUSTRY

Analyzing the Competition and the Industry

Acquiring Information About "The Industry"	
Action (how to do this)	Means
Identify the NAICS Business Classification Codes: Either use the Internet or the following books from a local library: *North American Industry Classification System or Standard industrial Classification*. Both books are published by The Executive Office of the President, U.S. Office of Management and Budget.	To search for applicable NAICS codes, use the web site http://www.census.gov/eos/www/naics/. Click on the link "2012" on the left side of the page to retrieve a listing of NAICS codes by industry type.
Identify terms that relate to the industry: Talk to others in the industry or read general interest articles.	Find other business owners in the local phone book or on the Internet who are in the same industry. Ask these persons what magazines they read and where they learn about industry trends. Google Adword keyword search tool is also a good way to find out which words are most associated with your chosen industry.
Find articles that relate to the industry and suppliers: Use the local library to find magazines, journals, or newsletters that experts identified. If experts were not able to identify publications, Mediafinder has a database of industry magazines, journals, and directories.	To find the names of specific trade magazines, use the Online Search at Mediafinder (http://mediafinder.com). For example, using the search term "janitorial" will reveal the titles of magazines and directories related to the cleaning industry. Then use your local library for the print version or the Internet to find the online version of these magazines. Web sites for magazines often have free searchable databases for older archived issues. One web site (http://www.findarticles.com) has full-text articles. As a fallback, you can always search for information using www.google.com where a list of most available resources will be provided. You may have to pick through a number of items before finding what you need. Also, be aware that some sites may make you register (provide your email address) before providing you with access to the publication, article, or document.

Acquiring Information About "The Industry"	
Action (how to do this)	Means
Find industry trends and statistics: In addition to reading articles, trade associations frequently maintain statistics and trends related to industries.	*Encyclopedia of Associations* (published by Gale Research) is an annual directory that identifies nonprofit membership associations. It is available at each of the 17 Small Business Development Center offices across the state. The book is also available at The University of Georgia's Main Library in Athens. Resources on the web used to identify associations include http://www.associationcentral.com, http://info.asaenet.org, and http://www.ipl.org/ref/AON/. When searching the web for industry statistics or trends, add the search terms "and statistics" or "and trends." For example, if interested in statistics related to restaurants, type "restaurants and statistics." Or, if interested in trends, type "restaurants and trends."

Product Positioning

Many marketing experts agree that once a business has identified its target market and determined its desired product positioning, then all of the other marketing components tend to fall into place more neatly. Product positioning refers to how consumers view your product or service relative to the competition. The positioning can be based on product attributes (such as price, quality, convenience, hi-tech) or occasion for usage (the early morning coffee house versus the late night coffee house) or user category (a restaurant's focus on "family friendly" or "date night" or "daytime workers"). While the low-price leader is a sought-after position, this position is usually difficult to sustain. The ability to differentiate your business from the competition in a way that is meaningful to consumers is key to long-term success.

Once the desired product position is defined, it must be clearly communicated to your target market. The original notion of positioning states

> *Positioning is not what you do to a product. Positioning is what you do to the mind of the prospect. That is, you position the product in the mind of the prospect.*[1]

A term often used in combination product positioning is *unique selling proposition* (USP). Essentially, the USP converts product attributes

[1] Al Ries and Jack Trout. Positioning: The Battle for Your Mind (McGraw-Hill Education. 2001).

Product Positioning

into benefits that fulfill customer needs. Usually presented in a one-sentence slogan, the USP can be extremely helpful in distinguishing a product or service from a host of competitive offerings. A few examples might help explain this concept.

- A women's clothing store in a small town seeks to distinguish itself from local mass merchandisers, discount clothiers, and metropolitan department stores. An appropriate USP would be *Babette's Boutique enhances your style by offering forward fashions and accessories.*
- A real estate agent could serve a growing Latino market segment by offering classes that teach the basics of buying a home by utilizing Spanish speaking instructors. *Su Casa Realty: Empowering you to successfully purchase a new home.*
- A chemical processing facility might want to stress the flexibility of its operations. *For customized chemical compounds, call ChemCare in Canton.*

Sales Forecasting

All of the research concerning target markets, competition, and positioning will be a vital component in forecasting sales. Take into account that your business is new and sales may be seasonal.

The basic formula for estimating sales is:

Market Potential x Average Purchase Intention x Charge per Unit

The market potential or total size of the market for your business should have been determined during your initial research. Additionally, the charge per unit will be calculated as part of the financial feasibility assessment. The average purchase intention will probably need to be calculated based upon a response to a primary research study or industry data. Once the business concept is refined, the target market identified, and the pricing structure estimated, then purchase intent can be ascertained. The following example of a telephone survey for a potential lawncare/landscaping service details the procedure.

Product concept: To provide timely and complete maintenance to residential and commercial greenscapes with optional seasonal services.

Services: Weekly lawn service (9 months), monthly tree and shrub maintenance (10 months), weed & feed (2 times per year), seasonal plantings (4 times per year).

Market potential: Four-county suburban area; 100,000 households (single, detached), but targeting mid-upper income areas, with high concentrations of young families who may not have time to maintain their lawn. Refined target market of households with incomes exceeding

$50,000 per year and presence of children: 3,000 targeted households.

Charge per unit (annual contract): $1,200 to be paid in monthly installments (excluding planting materials)

A telephone survey of 100 qualified households asks how interested each would be in purchasing these services. The responses are recorded in the following table.

Response	# of Responses	Deflation Factor*	Adjusted Frequency
Definitely purchase	5	0.80	4.0
Probably would purchase	10	0.50	5.0
Uncertain	30	0.25	7.5
Probably would not purchase	35	0.10	3.5
Definitely would not purchase	20	0.00	0.0
TOTALS	100		20.0

*Thomas Nagle and Reed Holden. *The Strategy and Tactics of Pricing* (Uppersaddle, New Jersey: Prentice Hall, 1995).

There are many reasons why a consumer might or might not be interested in purchasing your product or service. Some reasons may include availability, awareness, price, or purchase occasion, each being relative to competitive offerings. Therefore, the survey responses need to be adjusted for these market conditions. Using a deflation factor, a more conservative estimate of purchase intent is derived.

In the case of our lawn services example, if 20 percent of the target market were captured, 600 clients (3,000 x 0.20 = 600) would result. With 600 clients paying $1,200 in annual fees, sales would equal $720,000.

This sales figure becomes a vital component of the financial feasibility assessment and the overall determination of business feasibility. Also, keep in mind that it would take some time for the sample lawn service firm to achieve the projected 20 percent market share.

This is one way to forecast sales. Relevant industry experience can help a new business owner determine whether or not a sales forecast is realistically achievable.

The next section of this guidebook deals with the development of a marketing strategy. This strategy will focus primarily on the information gathered while researching market feasibility and will be implemented after starting a new business. Developing a marketing strategy prior to starting the business is important in order to prepare a marketing

Sales Forecasting

budget. This budget is based on what marketing tools will be utilized, what the marketing expenses will be, and when the integrated marketing programs will be enacted. Therefore, the marketing budget will have a significant impact on the financial projections used to determine financial feasibility. Over time, the marketing strategy and budget will change in accordance with market conditions.

Marketing Strategy

Prior to starting your business, you should plan how to market your business in order to reach your sales goals. This marketing strategy will go beyond basic promotional activities. It will also include a marketing schedule detailing when various marketing initiatives will be executed and a corresponding budget outlining the cost of the initiatives. This schedule and budget will forecast marketing costs in the projected income statements and cash flow statements.

Remember that some marketing efforts will take place before the business opens, and these costs are included in the pre-opening costs instead of in the monthly projections. Ongoing marketing efforts should be monitored for their effectiveness and continued appropriateness within the constructs of contemporary business conditions. Strategies and tactics will evolve as the business matures in response to the operating environment.

Marketing Communications

Communication strategies are the interface between a business and its market, which includes current and potential customers. Communication with other groups including stockholders, government entities (IRS, zoning boards and other regulative bodies.), and even the local business community affects how a business operates and the image it projects. Therefore, communication strategies should be carefully crafted in support of the overall sales and profitability objectives of the business. The following questions can guide a new business in developing a marketing communications strategy:

- What message are you trying to communicate to your target market(s)?
- What does your message state about the benefits of your product/service, the value received (benefits in relation to pricing), comparisons to the competition, how to purchase the product/service, how to contact you, etc.?
- Is this an effective message for the target market (are these benefits of importance to them)? What are the purchase decision criteria? Do different markets require different messages (i.e., multicultural marketing)?

Marketing Communications

- Is the message conveyed in an efficient manner? When is the best time (time of day, week, month, year, or relating to a specific event, etc.) to get this message to the target market(s)? What are the proper communication media (television, email, direct mail, etc.)?

- How do you want your business to be perceived as a result of the message? What image are you trying to achieve?

- What action do you want the target market(s) to take as a result (contact you, visit your store, set up an appointment, visit your web site, place an order, etc.)?

- What marketing activities provide the best "bang for the buck" (return on investment)?

- How will the effectiveness of the marketing activities be monitored? What practices positively impact sales?

An important design objective is to maintain a consistent message throughout the various marketing programs and activities. The programs should be integrated in order to reinforce one image or message. For example, a childcare center might want to emphasize the educational components of its services. Therefore, the target market would include parents and primary caregivers of preschool children. Important benefits to this segment would encompass kindergarten-readiness through an accredited program with properly educated staff, a documented curriculum, ample opportunities for parental and/or guardian interaction/support, and a well structured learning environment. Communication vehicles might include advertisements in local area newspapers or neighborhood newsletters. Accreditation programs also signify that a regional or national review board has deemed the program credible. It might even be feasible to partner with another childcare center in the area that specializes in infant care or in summer programs to support each other. Emphasizing cost or location over the educational aspects would not be consistent, even though these points may have some bearing on the clients' final choice for a preschool.

The Marketing Mix

There are a variety of ways to market a business to a target market. There is no need to "do everything for everybody." Efficiency is an important key to marketing success. A business owner should evaluate the marketing tools in relation to the target market(s) and within a reasonable marketing budget. A mix of marketing tools should be created, executed, monitored, and adapted, as appropriate. Because people learn through various modes (listening, watching, or doing), a mix of marketing tools can be helpful in spreading the message throughout the potential market. Use of multiple marketing vehicles will also reinforce a single message through fresh presentations.

The Marketing Mix

The following list of marketing mix tools (reprinted with the permission of The McGraw-Hill Companies) is from How to Write a Successful Marketing Plan by Roman G. Hiebing and Scott W. Cooper, copyright 1997 and originally published by NTC Business Books.

Marketing Tools

- Product - The product is the tangible object that is marketed to the target market for consumer goods, retail, and business-to-business companies. For service businesses, the product is a future benefit or future promise.

- Branding - Branding is the naming of the product, service, or company. A brand or name is the label that consumers associate with your product. For this reason, a brand or name should help communicate the product's positioning and its inherent drama for the consumer.

- Packaging - For manufacturers, packaging holds and protects the product and assists in communicating the product's attributes and image. For retailers and service firms, packaging is the inside and outside environment that houses and dispenses the product/services (stores, offices, etc.) and it helps communicate the company's attributes and image.

- Pricing - Price is the monetary value of the product. The monetary value is usually governed by what the target market or buyer will pay for the product and what the seller or company must receive for the product in order to defray costs and generate a profit.

- Personal Selling/Service - Personal selling for retail and service firms, often referred to as "operations," involves all functions related to selling and service in the store, office, or other environment, such as door-to-door solicitation, in-home selling, and telemarketing. This includes hiring and managing sales personnel, stocking inventory, preparing the product for sale, presenting and maintaining the facility, and follow-up service to the customers. For business-to-business and package goods firms, personal selling relates to the manufacturers' selling and servicing of its products to the trade and/or intermediate markets (various buyers of the product within the distribution channel from original producer to ultimate user). [Editor's note: Internet sales (also known as e-commerce) are included in this category as well.]

THE MARKETING MIX

Marketing Tools (Continued)

- Distribution - We define distribution as the transmission of goods and services from the producer or seller to the user. Distribution must ensure that products are accessible to the target market(s).

- Promotion/Events - Promotion provides added incentive, encouraging the target market to perform some incremental behavior. The incremental behavior results in either increased short-term sales and/or an association with the product (e.g., product usage or an event-oriented experience). In addition, promotion is more short term in focus.

- Advertising Message - Communication which informs and persuades through paid media (television, radio, magazine, newspaper, outdoor, and direct mail) constitutes the advertising message.

- Advertising Media - Advertising media are paid carriers of advertising, not at the point of purchase. While the advertising message is what is being communicated, the advertising media is how it is delivered.

- Merchandising - Merchandising is non-media communication of the company and/or product to the target market. This is the method used to communicate product and promotional information. Merchandising makes a visual and/or written statement about your company through an environment other than paid media, with or without one-on-one personal communication. Merchandising includes brochures, sell sheets, product displays, video presentations, banners, trade show exhibits shelf talkers, table tents, or any other non-media tools that can be used to communicate product attributes, positioning, pricing, or promotion information.

- Publicity - Publicity is any non-paid media communication which helps build target market awareness and positively affects attitudes for your product or firm. Publicity provides your firm or product with a benefit not found in any other marketing mix tool. Since publicity utilizes noncommercial communication, it adds a dimension of legitimacy that can't be found in advertising. You should also be aware that publicity -- editorial space and time for your product -- are only one part of public relations. Public relations deals with creating goodwill for an organization, not just for the short term, but also regarding long-term public opinion issues.

The Marketing Mix

Remember that the mix of marketing tools should be tailored to the type and location of a specific business; therefore, every tool listed is not necessarily suited for every business. Some will be more effective than others depending upon the type of business, target market, and competition. Keep in mind the objective of consistency while developing the mix of marketing tools. While a mix of media can be effective, mixed messages generally are not effective.

Since businesses do not operate in a static environment, marketing tactics should be revamped periodically in order to maintain a high "top of mind" awareness among consumers. Marketing research that captures and evaluates the competition, consumer trends, and customers' opinions and levels of satisfaction will help keep a business in tune with the market. This type of information will aid in market segmentation, product positioning, new product development, and other marketing strategies. The costs of marketing, including advertising, promotional events, merchandising, research, commissions, and other sales expenses, must be accounted for within the operating expenses of the business. These activities are necessary at least on some level to remain competitive and, therefore, must be considered as you build your marketing plan.

It is also important for any business to track, record, and document its return on investment, especially in marketing. This way the business owner will have a flowing record of which campaigns failed and which ones succeeded...and he/she might be able to detect emerging patterns. Certainly, knowing when something is working and where time/money can be shifted to something that does work is essential before making future marketing decisions. Start by establishing your baseline of customers and activities and then keep track of all marketing activities, events, advertisements, and how much money and time were spent on each. Calculate the total sales or new customers by the baseline to detect increases. You may also figure out specifically how many employee hours were spent promoting or working on creating this event by the overall turnout fairly easily. It is also a good idea to give the customer a key phrase or event name to which they can respond (or you may have your customer service representative ask how and where the customer learned of the event). In any case, it is important to find out which activities generate more revenue versus which ones create more work but have weaker returns so that you may adjust your future marketing plans. If you need help creating a marketing plan, make an appointmeant at your local SBDC office.

CHAPTER THREE: FINANCIAL FEASIBILITY

After determining that a potential market exists for your new product or service, the next step is to determine the financial feasibility of this endeavor. This estimate includes ascertaining how much money one needs to open the business (one-time expenses) and how much money is required until the business is generating enough cash to sustain itself. The final point of evaluation will be deciding whether the long-term profit potential is worth the time and effort necessary to arrive at that point.

In the start-up phase, having enough working capital for the short term is more important than being profitable. However, in the long term, the business must have both profitability and adequate working capital.

Estimating the Cost of Starting Your Business

The first step of this process is to develop a list of all the items needed prior to "opening the doors" of the business and serving customers. This list should include all capital assets such as land, building, inventory, equipment, and leasehold improvements. An amount of working capital must also be calculated. The forms on the following pages of this guidebook detail the basic calculations of estimating the capital requirements for starting a new business.

The worksheet, titled "One-time Expenses to Open Your Business," lists the most common one-time expenses that entrepreneurs encounter when starting a business. Feel free to tailor this worksheet to your specific business. Obtain at least three estimates for major expenses to support all figures.

Many entrepreneurs think that having enough funds to cover the initial expenses is sufficient to open the business. However, this is not the case. Having sufficient funds to *keep* the doors open *after* starting the business is also required. These additional funds, referred to as "working capital" or "operating capital," cover the day-to-day expenses that a business incurs. Until the business is generating enough revenue to sustain itself, working capital must be financed from other sources (i.e., personal, loans).

One critical element of working capital is payroll, including the owners' and employees' salaries. The second worksheet, titled "Personal Monthly Expenses," will help calculate salary requirements. Now is not the time to assume you can live more frugally than in the past. Try to estimate expenses realistically, perhaps using a higher figure than you will actually need. In other words, if the phone bill is estimated to run between $100 and $150 per month, use $150 for the estimate. Following this guideline should prevent a shortfall of cash for household expenses.

ESTIMATING THE COST OF STARTING YOUR BUSINESS

One-Time Expenses Needed to Open a Business

Accounting Fees	$__________
Legal Fees	$__________
Architectural Fees	$__________
Other Professional Fees	$__________
Licensing and Permits	$__________
Utility Deposits	$__________
Lease Deposit	$__________
Land	$__________
Building	$__________
Site Preparation	$__________
Telephone Installation	$__________
Equipment	$__________
Furniture and Fixtures	$__________
Installation of Furniture and Fixtures	$__________
Inventory	$__________
Office Supplies	$__________
Operating Supplies	$__________
Pre-opening Advertisement and Promotion	$__________
Other	$__________
Total of One-Time Expenses	$__________

Estimating the Cost of Starting Your Business

Personal Monthly Expenses

Home

House Payment or Rent	$________
Maintenance and Repair	$________
Home or Renter's Insurance	$________
Security	$________
Pest Control	$________
Electricity	$________
Gas	$________
Water	$________
Home Phone	$________
Cell Phone	$________
Internet Fee	$________
Cable TV	$________
Lawn Maintenance	$________
Property Tax	$________
Food	$________
Clothing	$________
Medical Insurance	$________
Medical Expense	$________
Household Supplies	$________
Entertainment	$________
Credit Card 1	$________
Credit Card 2	$________
Travel	$________
Dues/Subscriptions	$________
Contributions	$________
Miscellaneous	$________
Other	$________
Other	$________

Personal Monthly Expenses (Continued)

Auto

Loan payment 1.. $________

Loan payment 2.. $________

Insurance 1 .... $________

Insurance 2 .... $________

Maintenance and repair .... $________

Fuel .... $________

Tags... $________

TOTAL MONTHLY EXPENSES ....$________

MINUS:

Income from other sources.....................$________

EQUALS:

Personal Living Expense to be
covered by the business ....$________

PLUS:

Taxes (federal, state, and local).............$________

EQUALS:

Minimum salary requirements ....$________

Estimating the Cost of Starting Your Business

The salary requirements calculated in the previous worksheet will be used in the next worksheet: "Business Expenses for One Month." This worksheet will help determine the approximate working capital needs of the new business. The business expense worksheet is a starting point from which to evaluate the initial capital requirements for starting a business. Because the volume of sales affects some expenses (variable expenses), assume a given level of sales for an *average* month as well as a consistent level of product inventory.

Estimating the Cost of Starting Your Business

Business Expenses for One Month

Salary of Owner (see personal monthly expenses worksheet) .... $__________

Employee Payroll .... $__________

Payroll Taxes .... $__________

Advertising/Marketing .... $__________

Accounting/Legal Fees .... $__________

Materials or Inventory (assume an average month's sales) .... $__________

Operating Supplies .... $__________

Office Supplies .... $__________

Rent .... $__________

Equipment Leasing .... $__________

Utilities .... $__________

Telephone/Cell Phone .... $__________

Loan Payment (including interest) .... $__________

Insurance .... $__________

Taxes and Licenses .... $__________

Maintenance and Repair .... $__________

Bank Fees/Credit Card Fees (based on average month's sales) .... $__________

Security Fees .... $__________

Other .... $__________

TOTAL BUSINESS EXPENSES FOR ONE MONTH .... $__________

Estimating the Cost of Starting Your Business

After determining the "one-time expenses" and the "average business expenses for one month," apply a general rule of thumb to calculate the approximate amount of funds needed to start the business. It is prudent to raise funds that will cover anywhere from three to nine months of operating expenses, depending upon the type of business being started and its expected cash flow. In the table below, the monthly business expense factor should be multiplied by the expected number of months that it will take until monthly revenues exceed monthly expenses.

One-time expenses ....$__________

PLUS

Business expenses for one month
multiplied by (3 to 9 months) ....$__________

EQUALS

Approximate funds needed ....$__________

Before pursuing your idea any further, you should now analyze the total funds required to start your business versus the funds you already have and funds available to you. If you are seeking outside funding for your venture, Chapter 5 of this guidebook provides some important information.

Developing Financial Projections

After calculating the start-up expenses, the next step in determining financial feasibility is to develop financial projections. These projections will show how much profit the business has the potential to earn. Balance sheets, projected income statements, and cash flow statements can act as a report card for a new business. The projected financial statements will show how well the business is doing in terms of profitability, liquidity (cash available), and solvency (ability to repay debts).

BALANCE SHEET

The balance sheet is a relatively straightforward concept. It can be summarized by the accounting equation Assets = Liabilities + Owner's Equity. For example, assume that a business operates from a $100,000 building. A down payment of $20,000 was made, leaving an $80,000 mortgage. To put that into the accounting formula for the balance sheet, there is a $100,000 asset, an $80,000 liability, and $20,000 in owner's equity. Of the total assets, owner's equity is the portion of the assets *owned,* and liability is the portion of the assets for which money is *owed.*

The balance sheet represents the state of a business at a specific point in time, thus, it provides a snapshot of the business's financial health. The elements of the balance sheet are defined as follows:

Asset – An asset is any tangible or intangible item that has value and may be used by your business. Assets are usually categorized as current, fixed, or other. Current assets are assets that can be turned into cash within a 12- month cycle. The most common current assets are cash, accounts receivable, and inventory. Fixed assets are assets that will be used for more than one year, including equipment, furniture and fixtures, and land and buildings. Other assets are assets that fall outside the current and fixed categories, such as patents and goodwill.

Liabilities – Liabilities are debts incurred by the business and owed to others. Liabilities can be described as either current or long term. A current liability is one that must be paid within a 12-month period. Examples of current liabilities include accounts payable, taxes, and the current portion of your long-term debts. A long-term liability is one with a payback period exceeding one year. Examples of long-term liabilities include mortgages, notes payable, equipment loans, and loans to shareholders.

Owner's Equity – Owner's equity is the initial investment into the business, any earnings made by the business that are kept by the business (retained earnings), and any additional investments into the business.

The sample balance sheet should show where the money to start the business originated from and how it was used. The next worksheet may serve as a basis for your projected balance sheet. This template is a general example; tailor it to meet the specific needs and complexity of your business. The balance sheet should be completed based on how the business will look the day the doors open. This exercise will show what the business owns and what it owes at this initial point in time.

DEVELOPING FINANCIAL PROJECTIONS

SBDC "R" Us Gift Shop
As of December 31, XXXX

ASSETS		LIABILITIES AND EQUITY	
Current Assets		Current Liabilities	
Cash	$5,000	Accounts Payable	$12,000
Accounts Receivable	3,000	Sales Tax Payable	300
Inventory	50,000	Current Portion/ Long Term Debt	4,000
Total Current Assets	58,000	Total Current Liabilities	16,300
Fixed Assets		Long Term Liabilities	
Equipment	15,000	Equipment Notes Payable	30,000
Furniture & Fixtures	50,000		
Less Accumulated Depreciation	(30,000)		
Total Fixed Assets	35,000	Total Liabilities	46,300
		Owner's Equity	
		Owner's Investment	20,000
		Retained Earnings	26,700
		Total Owner's Equity	46,700
TOTAL ASSETS	93,000	TOTAL LIABILITIES AND OWNER'S EQUITY	93,000

YOUR BUSINESS
As of XXXXX, XXXX

ASSETS	LIABILITIES AND EQUITY
<u>Current Assets</u>	<u>Current Liabilities</u>
Cash .... $______	Accounts Payable .... $______
Accounts Receivable...... ______	Sales Tax Payable .....______
Inventory .... ______	Current Portion/ Long Term Debt ....______
Total Current Assets..... ______	Total Current Liabilities..................______
<u>Fixed Assets</u>	<u>Long Term Liabilities</u>
Equipment..................... ______ Furniture & Fixtures .... ______	Equipment Notes Payable ....______
Less Accumulated Depreciation ....(______)	
Total Fixed Assets......... ______	Total Liabilities..................______
	<u>Owner's Equity</u>
	Owner's Investment ..______ Retained Earnings ....______
	Total Owner's Equity ....______
TOTAL ASSETS.......... $______	TOTAL LIABILITIES AND OWNER'S EQUITY ....$______

Developing Financial Projections

INCOME STATEMENT

The income statement depicts the profitability (or lack thereof) of a business over a specific period of time. Income statements can cover any period of time, but usually cover the month, the quarter, or the year. An income statement details the business's revenues (money coming in) and expenses (money going out) over a specific period of time. The following are typical elements of an income statement:

Revenue – This is money coming into a business from the sale of its products or services. The chosen method of accounting will determine what month revenue appears on the income statement. (Accounting methods are described in detail in Chapter 7 of this guidebook.) When using the cash method, the revenue is reported when the cash is actually received. When using the accrual method, revenue is recognized when the earning process is complete, whether or not the cash has been received. A certified public accountant can help determine which accounting method is most appropriate for your business.

Cost of Goods Sold – This is the products your business sold during a specific period. It is not necessarily the products bought during that period, as there may be goods left in inventory from the previous period. Also, all of the goods available for sale may not necessarily be sold during that specific period. There is a standard formula to determine cost of goods sold. It is as follows:

	Beginning Inventory
PLUS (+)	<u>Purchases</u>
	Goods Available for Sale
MINUS (-)	<u>Ending Inventory</u>
EQUALS (=)	Cost of Goods Sold

Gross Profit – Revenue minus cost of goods sold is gross profit. Gross profit is a good indicator of purchasing and pricing behavior. Pricing too low or buying products too high may hurt gross profit. Check with industry standards to make comparisons.

Operating Expenses – These are the costs, other than cost of goods sold, of producing revenue through the sales of goods and services. These expenses may be fixed (constant) or vary from month to month. Variable expenses directly correlate with changing revenues. As revenues increase, these expenses increase, and, as revenues decrease, these expenses decrease. Changing revenues do not impact fixed expenses. Examples of variable expenses would be commissions and credit card fees. Examples of fixed expenses include rent, payroll, and professional fees.

Operating Profit – Operating profit is gross profit minus operating expenses. Operating profit is the profit earned during the normal course of operations.

Other Income and Expenses – Other income and expenses are not part of everyday operations. Examples of other income would be interest from marketable securities and dividends earned on investments. An example of other expense would be interest on debt.

Net Profit Before Taxes – Net profit before taxes is operating profit minus other income and expenses.

Net profit – Net profit is net profit before taxes minus taxes.

On the following page is a sample income statement.

Developing Financial Projections

INCOME STATEMENT

Income	$150,000
Cost of Goods Sold	70,000
Gross Profit	$80,000
Operating Expenses:	
Accounting Fees	250
Advertising	4,500
Bank/Credit Card Fees	3,000
Depreciation	5,000
Employee Payroll	12,500
Insurance	750
Legal Fees	250
Maintenance and Repair	250
Miscellaneous	300
Office Supplies	1,200
Officers' Salaries	20,000
Operating Supplies	3,000
Payroll Taxes	3,580
Rent	12,000
Security	360
Taxes and Licenses	220
Telephone	1,500
Utilities	1,800
Total Operating Expenses	$70,460
Operating Profit	9,540
Other Income and Expenses:	
Interest Expense	1,750
Net Profit Before Tax	7,790
Taxes	1,700
Net Profit After Tax	$6,090

Developing Financial Projections

A minimum of two-years' worth of income and expense projections are usually necessary to determine potential profitability and working capital needs. Projecting the income statement is the first step in determining how the cash will flow through your business. The information from the income statement will help create a cash flow projection. It is highly recommended that both projected statements be prepared on a monthly basis.

CASH FLOW STATEMENT

Oftentimes it is possible for your business to be profitable in the short run while experiencing a negative cash flow; that is, more money is being paid out of the business than is being received. Therefore, it is important to understand how cash cycles through your business. The cash flow statement documents this cycle.

There are two methods for developing a cash flow statement: the indirect method and the direct method. The indirect method takes the net profit from the income statement and adjusts it according to the changes in the balance sheet accounts for the given period to give you the actual cash flow. For the purposes of this guidebook, we will focus on the direct method because it is easier to conceptualize and shows the direct link between cash in or out from operations, financing activities, and investing activities. An accountant can offer more information on the indirect method.

Cash from operations is the result of cash coming into the business and cash going out of the business due to normal, daily activity. Cash coming into the business from operations is cash from cash sales during a given period and from account receivables actually collected during that period. Cash going out of the business due to operations consists of routine expenses such as inventory purchases, payroll expenses, and operating expenses such as rent, utilities, etc.

Cash from financing activities is the result of cash receipts from loans or cash out for loan payments or lump sum payments. Cash from investment activities is typically cash received from investors or owners of the company or cash paid out for assets of the company.

As a business idea evolves, the assumption of six months' worth of cash on hand to cover expenses may become less accurate. Month-to-month projections of cash flow will provide a more accurate estimate of how much working capital is needed to keep a business operating. The cash flow statement should be the main guide for determining cash flow needs.

Developing Financial Projections

The following template may be used to develop your own cash flow projection. The template is only a guide and should be tailored to your particular business. The cash flow projection will show when there will be a cash deficit and how large that cash deficit grows before the business brings in enough cash to sustain itself. If there is a negative cash estimate, you must secure cash from financing or investment options to cover the cash deficit. In the short run, cash flow is all that matters. In the long run, profitability is also important.

Projected Monthly Cash Flow
YOUR BUSINESS
Month 1 Through Month 12, 20XX

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	etc...
Cash Receipts from Operations:							
Cash Sales							
Accounts Receivable							
Other Cash Receipts							
Total Cash Receipts from Operations:							
Cash Receipts from Financing or Investing							
Bank Loan							
Owner's Investment							
Other							
Total Cash Receipts from Financing							
TOTAL CASH RECEIPTS							
Cash Disbursements from Operations:							
Purchases/Inventory							
Accounting Fees							
Advertising							
Bank/Credit Card Fees							
Employee Payroll							
Insurance							
Legal Fees							
Maintenance and Repair							
Office Supplies							
Officer's Salaries							
Operating Supplies							
Payroll Taxes							
Rent							
Security							
Taxes and Licenses							

Projected Monthly Cash Flow
YOUR BUSINESS
Month 1 Through Month 12, 20XX
(Continued)

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	etc...
Telephone							
Utilities							
Miscellaneous							
Total Cash Disbursements from Operations:							
Cash Fisbursements for Financing or Investing:							
Loan Payments							
Equipment Purchases							
Other							
Total Cash Disbursements for Financing or Investing:							
Total Cash from Operations, Financing and Investment							
Net Cash Flow							
Beginning Balance							
Cumulative Cash Flow							

Evaluating Financial Statements

There are various methods of analyzing the potential success of a new business. In the early phase, a business should try to incur only profitable debt (i.e., more money is returned to the business via the loan than it costs to pay for it). In addition, do not forget the opportunity costs of running the business; that is, could more money be made doing something else, or could this investment bring a better return if invested elsewhere. If the best case scenario for the proposed business does not meet financial requirements, seek a more promising opportunity.

Another important determination of financial feasibility is the break-even point. The breakeven point is defined as the level of sales at which there is neither a profit nor a loss. Total revenue equals total expenses. In other words, a business will not generate a profit until it reaches its breakeven point. The question to be addressed is, can the business generate enough revenue to surpass the breakeven point? To calculate this point, certain assumptions must be made about the level of business: (1) the percentage of variable cost associated with a given level of sales and (2) the total fixed costs for the company at that given volume of revenue. For example, assume the following scenario:

Unit Revenue:............................... $5.00

Cost of Goods Sold......................... -2.00

Contribution Margin...................... 3.00

Or ....60 percent

($3.00/$5.00=0.60 or 60%)

Fixed costs $75,000

Breakeven...... $75,000/0.60 = $125,000

If overhead expenses, such as rent, salaries, utilities, etc. amount to $75,000 (these do not change no matter how the sales volume changes within a given range), then that fixed amount can be divided by the contribution margin to calculate the breakeven point. In this example, it is $75,000 divided by 0.60 equaling $125,000. At $125,000 in revenue, the business neither makes money nor loses money from a profit and loss standpoint. So the minimum sales level to break even is $125,000. Breakeven point may be expressed in dollars, as in this example, or in units sold.

The financial projections are a part of the overall business plan and are developed in conjunction with the narrative. The projections result from the actions you are planning to take as you start and manage your business.

Evaluating Financial Statements

In order to estimate numbers for the financial projections, a thorough understanding of the market, the competition, the positioning of the proposed product or service, and the day-to-day operations of this type of business are needed. These elements comprise the outline for a business plan and underscore the importance of hands-on experience in the proposed type of business. Previous industry experience can also provide the entrepreneur with a keen sense of mission critical operations before investing money and taking risks in a new business.

The development of conservative, realistic financial projections is a trial and error process requiring several iterations. Financial projections will require updating and revising throughout the business plan deployment process as well. Given a satisfactory knowledge of market feasibility and financial feasibility, the entrepreneur can take the information generated from these evaluations to build a business plan.

CHAPTER FOUR: PREPARING A BUSINESS PLAN

The task of writing a business plan can be intimidating but rewarding. A good business plan can help identify areas of strengths and weaknesses, locate potential problems, define your business's needs, and establish goals. Many authors have described business plans as a "road map" or "blueprint" from which a business can operate. In addition to being a good operating tool, a business plan builds credibility in a loan proposal and distinguishes your business from a lender's perspective.

Preparing a good business plan will require hard work and may take a few weeks to several months to complete, depending on the issues that need to be addressed in your plan, your writing skills, and your skills in preparing financial statements. Many entrepreneurs rush through the preparation of business plans, often leaving out important details. Some of the common weaknesses business plans possess include:

1. Irrational, unachievable, or unrealistic business strategies
2. Competition not identified in detail
3. Marketing plans weak to nonexistent
4. Profitability and growth not addressed
5. Poor market research and selling strategies
6. Inadequate financial projections

(Source: Mancuso, Joseph R. *How to Get a Business Loan: Without Signing Your Life Away*. New York: Simon and Schuster, 1992.)

The first step in writing a business plan is to look at your business idea objectively. If you have conducted the market and financial feasibility assessments as prescribed in this guidebook, you will be able to demonstrate how this business will meet the goals you have set for it. Reviewing successful business plans, especially in your industry, will help you address key factors in your own business plan. Trade associations often have resources, such as sample business plans and industry data, to help you build your business plan. If you are considering buying a franchise, franchisers usually have sample plans and useful information.

While looking at other plans is a good way to get new ideas and perspectives, your business plan needs to represent your ideas, your situation, and your strategies. Avoid copying plans. Don't be tempted to simplify the planning process by relying solely on business planning software. Even though these software packages offer friendly menus and fancy graphics, most loan officers have seen hundreds of these boilerplate templates and you will run the risk of turning a lender off your idea. A good business plan should reflect the key issues important in your business. Copying business plans or using templates may leave key issues untouched. Furthermore, using templates or borrowing too heavily from existing plans may hurt the flow of the plan, causing confusion and possible irritation for lenders.

Elements of a Business Plan

A business plan outline is typically the same for nearly every business; however, the type of business and the goals of the business will dictate the content and emphasis within the business plan. For example, a start-up retailer might focus on inventory and marketing issues in its business plan, whereas a start-up manufacturer might focus on production and distribution issues. Similarly, business plans intended for an investor may differ from those prepared for a traditional lender. A traditional lender will probably want to read a plan that supports repayment of a loan, whereas an investor will want to read a plan that will detail how the company is going to build value and the expected return on investment. Whatever purpose the business plan is serving, the following format serves as a sound beginning point:

- Cover Page
- Executive Summary
- Business Description
- Business Location (if new business or new territory)
- Operations
- Market Analysis
- Marketing Strategy
- Management and Personnel Operations
- Financial Information
- Attachments and Supporting Documentation

COVER PAGE

The cover page is the first page the reader sees, so it is important to make a good impression. The cover page should contain reference information, including the proposed business name and logo, the owner's name, address, phone number, email address, web site (if applicable), and a date.

EXECUTIVE SUMMARY

The executive summary highlights the key points of the business plan. The summary should provide a brief description of the business, the owners, and the purpose of the plan itself. If you are presenting the business plan to a loan officer, the executive summary will act as a "sales pitch." This section is typically the first section read; therefore, you must build interest in your summary so that the reader wants to read the entire plan. This section is usually no more than one page for traditional lenders; however, it may need to be longer if the reader is an investor. When a business plan is being used to support a loan proposal, the executive summary should contain the following information:

- Business name and nature of the business

- Business owner(s) name(s) and contact information

Elements of a Business Plan

- Legal structure
- Amount and term of loan request
- Uses of loan
- Statement of confidentiality

BUSINESS DESCRIPTION

The first major section of any business plan should be a description of the business. This section provides background information about the new business and the general business concept. This section also describes products and services sold by the business, as well as goals and strategies for achieving those goals. In addition to opportunities upon which this business will capitalize, foreseeable challenges should also be identified. Lenders and venture capitalists may not find a plan believable if it paints too rosy a picture. Where applicable, these topics should be discussed in the business description:

- Mission of the business
- Type of business (service, retail, construction, wholesaling, manufacturing, e-business)
- Legal form (sole proprietor, partnership, corporation, limited liability company)
- The company's strengths and strategies
- Vulnerabilities and protection steps
- Description of products and services
- Description of target market
- Features and benefits of products and services
- Unique selling position (how your business differentiates itself from the competition)
- Research and development (for technology-based companies and manufacturers)
- Production and service delivery (for manufacturers)

BUSINESS LOCATION

The business plan should explain why the proposed location was selected. For example, proximity to customers, access to distribution channels, or lower costs are all justifiable reasons for selection. Furthermore, the plan should include an assessment of a new facility. If a loan is being sought to finance a new facility, the business plan should give considerable detail about the proposed uses of capital. Other related items in this section of the business plan include:

- Address
- Facility(s) description (zoning, renovations, buy or lease, equipment)
- Traffic patterns /foot traffic (when, how many, who)
- Surroundings and proximity to other businesses (if important)
- Parking
- Area demographics (ex. number of households)

For consulting, service, or home-based businesses where the customer does not purchase while physically at the business address, less location detail is needed. Modify the location section to fit your situation.

MARKET ANALYSIS

As mentioned before, the weakest area in many business plans is the market analysis. A weak analysis can be detrimental because this section sets the stage for the marketing strategies. The information gathered during the marketing feasibility assessment phase will be of great value when constructing this section of the business plan. The market analysis should contain information about the environment in which this business will operate — specifically, industry trends; customer trends; and any pertinent legal, political, or environmental information. Included in the industry analysis are descriptions of direct and indirect competitors. Show how this new business will be different from the existing competitors. Do not claim that there is no competition. Lenders and investors will not take seriously a business that claims no competition.

Documentation of information sources should be evident. Lenders and investors discredit plans with poor or no documentation. The main components of a market analysis include the following topics:

- Market overview
  - Industry size (sales, volume, number of suppliers)
  - Factors that influence growth or decline (interest rates, seasons)
  - Past and current industry trends (new technologies, product changes, etc.)
  - Regulations (if applicable)
  - Other industry statistics
- Target market and segments
  - Demographics (age, sex, race, income, etc.)
  - Size of potential customer base

    - Trends in segments
- Market position/market share
- Competition analysis
    - Direct Competitors
    - Indirect competitors
    - Proximity
    - Product and service comparisons (quality, pricing)
    - Facility comparisons
    - Advertising and promotion comparisons

MARKETING STRATEGY

This section of the business plan describes how your business will achieve its sales goals through various marketing strategies. Outline the action steps that you will need to take in order to reach potential customers. Include strategies for advertising, promotions, pricing, and selling. Also discuss your strategy for differentiating your business from the competition. Overall, the reader of your plan should get a firm understanding of how you plan to compete in the marketplace. In the Marketing Strategy section you can discuss the following topics:

- Marketing plan
    - Marketing goals (ex. attract customers, launch product, promote name)
    - Branding/differentiation
    - Pricing strategy
    - Advertising
    - Marketing systems (plan to attract and retain customers)
    - Promotions
- Sales Plan
    - Sales goals
    - Sales staff and training
    - Sales tools
    - Sales forecast
- Distribution (if applicable)

MANAGEMENT AND PERSONNEL

This section of your plan, the second most important section of the business plan and ALWAYS the most neglected, should detail the proposed organizational structure of your business. The plan should describe the backgrounds of owners and key management, listing their relevant management and industry experience. The lender will ascertain if the business has key positions that are vital to the success of the business covered. Banks, lenders, and investors consider the management team the most important predictor of a successful business. Key outside advisors and consultants should also be mentioned. Other relevant components of this section include:

- Owner(s) and management team background
- Staffing plan/number of employees
- Personnel duties and requirements
- Compensation/benefits
- Recruitment and training

OPERATIONS

This section gives a general description of the business operation. You should describe what happens to the business on an average day. Hours of operation, scheduling, and workflow are important operational issues. Additionally, many use this section to describe other activities such as inventory control, quality assurance, storage, accounting, and other administration and support activities. If you are a manufacturer, cover your production process and explain equipment and technology requirements. In this section give an overview of the following areas and issues:

- Hours of operation
- Manufacturing process (for manufacturers)
- Equipment requirements
- Quality control
- Outsourcing (if applicable)
- Legal and accounting

FINANCIALS

The most important element of a business plan/loan proposal is the financial section. Financial information is critical for you to determine the financial feasibility of your venture and for a lender to evaluate a business. With no financial history, start-up businesses will need to justify their loan requests with financial forecasts. Most important for start-up companies, a financial plan attaches dollar figures to the other elements of the business plan in order to evaluate or demonstrate the financial feasibility of a business venture. Because lenders often view projections from new business ventures as too optimistic, projections need to be conservative and supported by sound research.

When preparing financial statements and projections, one should follow *Generally Accepted Accounting Principles (GAAP)*. Lenders are familiar with financial statements following these principles. Any deviation or contradiction to these principles may raise skepticism about the condition of the business and the abilities of the owners. A lender will expect at least two years of projections (possibly more, depending on the lender and type of business). Financial information you need to have in your plan includes:

- Sources and uses of funds
- Pro forma income statement
- Cash flow projections
- Pro forma balance sheet (if required)
- Break even projections (for start-ups)
- Notes and assumptions to financial projections

Understanding financial information and how it is calculated will serve as a valuable management tool. This information is covered in Chapter Three but is also included in this Chapter to emphasize its iportance. If you find yourself overwhelmed by this process, call your local SBDC office or your accountant for assistance.

Sources and Uses of Funds

The projected budget is a complete listing of anticipated sources and uses of funds. Sources of funds describe the amount of financing needed and the required equity from owners. This list usually includes items such as cash injection, bank loans, and venture capital contribution. If applicable, include in your projected budget the value of collateral that will be pledged to secure a loan. Uses of funds generally lists all capital and operating expenditures required prior to start-up. This statement may include items such as land and building, equipment, deposits, and working capital (see page 31).

Pro Forma Income Statement (profit and loss statement)

The pro forma income statement, also known as the "projected profit and loss statement," is a forecast of your income and expenses for an operating period (typically one year) (see pages 38-40). The difference between income and expenses is a business's net profit or loss. The pro forma income statement should be based on sound research and should be considered reasonable. There should be a methodology or reasoning behind all dollar figures. An income statement will consist of the following information:

Sales Revenue

For a new business, the sales forecast is the most difficult item to project. A good projection is based on strong market research and a solid methodology. Some companies use sales forecasting models to project sales. Many models are based on probabilities of likely events such as the number of customers that will purchase daily or the likelihood of the business reaching a percent of full capacity. Some companies use surveys and other market research tools to validate their sales forecasts. Additionally, industry standards, franchise information, and local observations can defend a sales forecast.

Cost of Goods Sold

Simply put, the cost of goods sold is the decrease of your inventory used in generating sales revenues. Cost of goods sold is a variable expense that increases as sales increase. Some businesses such as manufacturers include labor as part of cost of goods since labor costs increase with sales. The difference between sales revenues and the cost of goods sold is the gross profit margin. Keeping a good margin to cover operating expenses is crucial. For new businesses, industry standards and/or financial studies such as those published by IndustriusCFO (www.industriuscfo.com) can build a basis for pricing, costs of goods sold, and gross margins.

Expenses

All operating expenses should be based on research and quotes from venders; these expenses should be identified as fixed or variable in creating the pro forma. Fixed expenses are independent of sales and remain constant no matter what the sales situation is with the business. Variable expenses are expenses that increase or decrease depending on the level of sales.

As mentioned before, the sum of the income and expenses is the business's profit. When compiling the pro forma income statement, every business owner should consider the following factors:

- The income statement should be developed in conjunction with cash flow projections.
- The statements should be prepared for at least two years, the first year prepared monthly and the second year either monthly or at least quarterly.
- The amounts support the basis of your estimates; therefore, it is important that you compare with industry norms.

Elements of a Business Plan

Cash Flow Projections

A cash flow projection forecast of the inflows (receipts) and outflows (disbursements) of cash can be seen on pages 43-and 44. The cash flow statement is a good planning tool because it helps a business owner to prepare for anticipated uses of cash and identify cash deficits. A detailed cash flow forecast, which is understood and used by management, can direct attention to areas with the greatest needs. The cash flow projection monitors three important cash flow categories: cash from operations, cash from investing, and cash from financing. Operating activities include sales, expenses, accounts receivable, inventory changes, and accounts payable. Investing activities that can change the cash position in a business include the purchase of property (i.e., land, building, and equipment) and the sale of assets. For small businesses, financing activities such as loans and repayment of loans change the cash position of a company. The total dictates a business's need for cash. For lenders, the cash flow details how the business will be able to pay back both the principal and interest on a loan.

The cash flow statement is often confused with the income statement. Many inexperienced owners have gotten into financial difficulties because they did not understand the difference between these two statements, often resulting in business failure. Being a profitable business is not the same as having a strong cash position. Changes in the balances of some items such as accounts receivable, inventory, accounts payable, principal, or assets will not directly be reported in a profit and loss statement but would in a cash flow statement. For example, if you buy a $30,000 vehicle for your business, you could expense the depreciation on the truck; however, the actual cost of the truck would not be recorded on your income statement. Instead, this cash expense would be recorded on a cash flow statement (-$30,000). Understanding that net profit is not net cash will help any business survive profitably.

In preparing your cash flow projections, consider the following:

- Seasonality characteristics of the business as they affect sales and expenses
- Information from the project budget/sources
- Exclusion of all non-cash items including depreciation and amortization

A typical cash flow projection will flow in the following format.

Beginning Cash Balance – Available cash balance at the beginning of the month

Cash Inflows (+)
- Cash Sales
- Collections of receivables
- Trade discounts
- Loan proceeds
- Sales of assets (land, equipment, etc.)
- Equity injections

Cash Outflows (-)
- Operating expenses
- Inventory purchases
- Capital equipment purchases
- Principal and interest payments

Net Cash – The difference between cash inflows and outflows for each month

Ending Cash Balance – Beginning cash balance plus net cash

Pro Forma Balance Sheet (see pages 34-37)

Put simply, the balance sheet reports the assets and equities (liabilities and owner's equity) of a business at a specific moment. The balance sheet encompasses information from the project budget (sources and uses of funds), pro forma income statement, and projected cash flow statements, and divides accounting transactions from these statements into the following balance sheet categories: assets, liabilities, and owner's equity.

Assets are generally divided into current and long-term assets. Assets are usually listed in their order of liquidity. Current assets such as cash, accounts receivable, inventories, prepaid expenses, and other short-term assets are listed first. All of these assets are liquid because they are expected to be converted to cash or consumed within one year. Long-term assets include land, buildings, and equipment, less accumulative depreciation. Liabilities are listed similar to assets, with current liabilities (less than one year) listed first. Current liabilities include accounts payable, taxes payable, short-term notes, and accrued wages. Long-term liabilities include long-term debt and other liabilities over one year in maturity. Equity is the difference between assets and liabilities and accounts for retained earning and owners equity. The term balance comes from the accounting principle that assets equal liabilities plus owner's equity. Because of the dual aspect concept of the balance sheet, both sides of the equation must add up to the same total. In other words, they *balance*.

For new businesses, a lender may or may not require a balance sheet. For many lenders, the sources and uses of funds statement is enough to satisfy balance sheet requirements. If a balance sheet is required, it should be prepared in a format that is easy for the loan officer to analyze the debt and equity position.

Breakeven Projection

Breakeven is a method generally used to determine the exact level of sales needed to cover all costs. For new businesses it is crucial for an owner to understand the breakeven point. In simple terms breakeven is the point at which total sales equal total costs. Total costs consist of fixed and variable costs. Variable costs increase directly in proportion to the level of sales in dollars or units. Typical variable expenses include cost of goods sold, commissions, cost of direct supplies, delivery charges, and in some cases labor costs. Fixed costs remain the same regardless of the level of sales. Typical fixed expenses include rent, insurance, office supplies, licenses, and salaries of permanent workers. Some costs are a combination of fixed and variable. If the costs are easy to separate, you should do so to give a better break-even analysis. The basic formula for breakeven is:

Sales (minus) Variable Expenses
(divided by) Sales = Contribution Margin %

Fixed Expenses (divided by) Contribution Margin %
= Breakeven Point

Example: Company - Ron's Bait and Tackle

Sales	$200,000	100%
Variable Expenses		
Cost of Goods	100,000	50%
Operating Supplies	4,000	2%
Bank Charges (Visa)	1,000	0.5%
Total Variable	105,000	52.5%
Fixed Expenses		
Payroll	40,000	
Utilities	5,000	
Insurance	1,000	
Advertising	2,000	
Loan Payment	3,000	
Total Fixed	51,000	

Contribution Margin % = 200,000 - 105,000/200,000 = 0.475 (47.5%)

OR 100%-52.5% = 0.475 (47.5%)

Breakeven Point = 51,000/.475 = $107,368

Notes and Assumptions to Financial Projections

Notes to financial projections explain in detail the assumptions, calculations, and accounting methods and concepts used to prepare cash flows, income statements and balance sheets. **Financial notes are absolutely necessary for a lender to fully understand your loan proposal.**

ATTACHMENTS AND SUPPORTING DOCUMENTS

Attachments and documents are used to provide support for the business plan. This section should contain information that is pertinent to the plan or loan proposal such as a detail equipment list and invoices. Furthermore, this section can also include items such as management resumes, market research, licenses, facility or store layout and other items listed under required documentation.

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CHAPTER FIVE: OBTAINING A LOAN FOR YOUR NEW BUSINESS

Applying for a business loan can be a difficult and tedious task. Bank requirements, government loan guarantees, and loan conditions can frustrate any prospective business owner. Before a lender or investor will lend funds for a business endeavor, he or she wants to know that you have thoughtfully planned your future actions; therefore, it is imperative that you effectively communicate your intentions. Having a well thought out business plan that includes financial projections becomes paramount when submitting your loan proposal for approval, especially for new business ventures.

Understanding the approval process that financial institutions employ can help you plan for a realistic, well organized loan proposal. Typically, a loan officer evaluates a proposal against five criteria, sometimes referred as to the "Five C's of Credit:" character, capacity, capital, conditions, and collateral.

Character/ Credit History

The first qualifying document that a lender reviews will be your credit report. The credit report is used as an indicator of character because it provides a history of your current and past financial obligations. Lenders do not want to see late payments, missed payments, bankruptcies, judgments, or liens on your credit report. An occasional late payment is typically not harmful, as long as there is no pattern. However, bankruptcies, collections, and a series of recent late payments will be detrimental to a loan application. Any tax liens or judgements will need to be paid prior to a bank approving a loan.

You should obtain a copy of your credit report for review prior to applying for a loan. Credit reports can contain inaccuracies. If your credit report is erroneous, you may have time to correct it. Typically, corrections can take between a couple of weeks to several months before they appear on the credit report. Also, be aware that your credit report reflects recent inquiries about your credit history. If you are shopping for banks, high activity such as the number of recent inquiries may negatively influence the lender's opinion of your credit worthiness. Contrary to what many people think, accurate but unflattering information is virtually impossible to remove from a credit history. If your report reflects any poor past performance, you should include a letter within your loan proposal explaining these circumstances. A death in the family, sickness, and divorce are explainable circumstances with which a lender may empathize. Be open and honest with your lender about your credit history. **DO NOT HIDE THE FACTS.** If you do not have a current credit report, order one by calling:

- Equifax at (800)685-1111 or
- TransUnion at (800)888-4213 or
- Experian at (888)397-3742

Character/ Credit History

In addition to examining your personal credit history, a lender will analyze other factors indicative of character and integrity, including the length of your residency, your education, your experience in the field, and your standing in the community. One of the primary reasons for business failure is the lack of managerial experience. The lender will ascertain if you have relevant job experience and also if there are key personnel positions vital to the success of the business.

Capacity/Cash Flow

For a lender, the most important issue to determine is "Can the loan be repaid?" The key to a new business's repayment ability is its projected cash flow. Simply explained, cash flow is the net of cash inflows and cash outflows. A prospective borrower must show how the business's sources of cash are not being outstripped by its uses of cash. A good cash flow projection will show how the loan proceeds will be used, how long the business will generate a positive cash flow, and how the business will cover cash "gaps" (outflows exceed inflows). Gaps are typically caused by fluctuations in inventories, accounts receivable, accounts payable, and increases in assets. A lender will want to know how a business plans to manage these "gaps."

For existing businesses, lenders initially look at the business's profit and loss statements, balance sheets, and cash flow statements to determine if, historically, the business has enough cash flow to repay the loan. Since new businesses do not have historical financial statements, lenders typically have a difficult time assessing a new business's capabilities for repaying a loan. **This is why *realistic* cash flow projections are the most important financial statement in a loan proposal.** A formal cash flow projection assures the lender that you have enough projected cash available to pay back the loan.

Additionally, the nature of the loan request can affect the application. The loan request must be reasonable for its scope and terms. How much does the business need? How will loan proceeds be used? What is the length of the requested financing? A lender will decide the reasonableness of the loan request and ultimately ensure that the cash flow matches the requested loan structure. Therefore, do not inflate loan needs, but rather keep them realistic and attainable.

Capital/ Equity

Essentially, lenders look for a strong commitment from a borrower. Most of the time, this commitment takes the form of equity you invest in the business. Equity could be in the form of cash or other business or personal assets such as equipment, land, or buildings. Do not be surprised if the bank asks for your personal assets to be injected into your project. If you have equity in your home, be ready to pledge it if you do not have any other forms of equity. If you are not willing to put up a personal asset, you should consider why a lender would take a risk on your business, if you are not willing to take

Capital/ Equity

a similar risk yourself. Lenders understand that there is a positive correlation between a borrower's commitment and the likelihood that the loan will be repaid. The amount of equity required by a lender varies. Depending on the risk of the proposed venture, you may be required to inject up to 50 percent of the total capital needed. However, an average of 20 to 25 percent is commonplace.

Collateral

Even though you may have every intention to pay back a business loan, there is still a possibility that your business might endure unpredictable events that even the best planned businesses cannot anticipate. Natural disasters, economic downturns, lawsuits, delinquent receivables, supplier problems, and changes in demand can paralyze any business's cash flow. Because of the risk that a lender takes, a loan will most likely be secured by collateral. If a borrower defaults on a loan, the bank has the option to foreclose on the collateral.

Business and personal assets can be considered collateral. If you are buying land, equipment, or a building for the business, the assets may be enough to secure the loan. Lenders have developed acceptable loan-to-value ratios for assets pledged toward loans. Factors that influence ratios include the age and condition of the asset, liquidation value, and costs. Loan-to-value ratios may vary between lenders. Furthermore, loan-to-value ratios may be based on lending criteria rather than on the value of the collateral. Before pledging any assets, you need to know the lender's loan-to-value ratio on assets. Here is a typical example:

Assets	Low Value (%)	High Value (%)
Real Estate	70%	90%
Equipment	50%	80%
Inventory	0%	50%
Receivables (60 days)	70%	90%
Securities, Stocks, Bonds	65%	80%
Leasehold Improvements	0%	70%

(Source: Blechman, Bruce, and Jay Conrad Levinson. *Guerrilla Financing*. Boston: Houghton Mifflin Company, 1992.)

If you are borrowing money for "soft" reasons such as inventory, working capital, or leasehold improvements, a lender will require additional collateral or equity to fully secure the loan. Working capital and leasehold improvements are not collectable. Likewise, if you want a long-term loan to buy equipment with a short depreciation schedule (ex. computers) or equipment that has a poor liquidation history (ex. restaurant equipment), a lender will probably require you to pledge additional assets.

When you pledge collateral such as equipment, you sign a Uniform Commercial Code (UCC) Security Agreement with the lender. When this agreement is signed, the lender has the right to take possession of the collateral without going to court. The agreement gives the lender the right to the proceeds from the collection, sale, or exchange of the collateral.

Conditions

The economic environment, industry trends, changes in technology, market trends, legal issues, labor trends, the company's strategies and approaches, and the strength and experience of management are some of the conditions that a lender looks for in addressing the "soundness" of the loan proposal. Many banks have lists of businesses that have poor risk ratings due to these factors. Loan officers are more likely to lend to businesses that can show proof of a sound management team, a unique or competitive advantage, little or no competition, and a strong customer base. If a business has major challenges such as economic, legal, employee, supplier, or environmental issues, it needs to address them in the loan proposal.

Types and Uses of Loans

When starting a business, one can raise capital in two ways: equity financing or debt financing (loans). Simply put, equity financing is money put into your business by private investors (also known as venture capitalists). Equity financing typically does not require collateral; however, since financing is based on a participation of ownership, performance requirements may be placed on the business in order to maximize a high return on the investment. Alternatively, banks, credit unions, and non-bank lenders offer several types of debt financing. Many businesses starting use debt financing to fund their business needs. Unlike venture capitalists, lenders don't take ownership in the business, nor do they share in the profits. They simply expect you to repay the principal with interest.

Most lenders have several loan types or products. Most loan products are categorized by the security (collateral required), the maturity of the loan, and the intended use of the funds. Terms may vary greatly between lenders, so investigating your alternatives is very important. A number of variables can affect the appropriateness of a loan for a specific business.

With so many sources of funds and several loan products available today, picking the best source and best loan type to start your business may be a daunting task. The following chart shows common types of loans that have been used to start businesses.

Types and Uses of Loans

Common Loan Types

Maturity and Loan Type	Characteristics	Secured or Unsecured	Interest	Payment Terms
Short Term (<1 yr.)				
Credit Cards	Most common form of short-term credit. Many small businesses use credit cards to buy supplies and other necessities and to pay for everyday purchases.	Unsecured	Fixed or Variable 10-24%	Monthly 2-3% of average daily balance
Line of Credit	Lender agrees to lend money for a specific time period, usually one year, or amount. Lines can be used to facilitate the purchase of inventory/ equipment and cover seasonal business fluctuations.	Secured (most)	Fixed or variable, 1-4% above prime	Monthly. Interest on credit used and balance due at end of contract.
Intermediate (1-7 yrs.)				
Term/ Installment	Term loans are set for a specific amount for a specific time period. They can be used for equipment purchases, working capital, and expansions.	Secured	Fixed 1-4% above prime	Monthly or quarterly Principal and interest
Leasing	Alternative to term loans; lender rents asset to lessee. Leasing enables a company to acquire equipment without all the cost at the outset. Little or no down payment; company can purchase equipment at the end of the lease (as low as $1 by prior agreement).	Secured	Market Rate	Monthly
Long Term (7+ yrs.)				
Term/ Installment	Term loans with maturity dates longer than seven years. Used to purchase factory equipment or other long-term assets.	Secured	1-3% above prime	Monthly or quarterly principal and interest
Commercial/ Mortgages	Business loan that involves real estate. A mortgage is the legal document that insures the payment of the borrower.	Secured	Fixed and variable 1-2% above prime	Monthly or quarterly Principal and interest

U.S. Small Business Administration

The U.S. Small Business Administration (SBA) offers bank and non-bank lenders guarantees for loans made to qualified small business concerns including new businesses. Guarantees protect the lender up to 85 percent of the original loan principal if the borrower fails to repay. The purpose of the guarantee is to encourage lenders to make loans to small businesses that would typically not be considered under normal criteria. SBA guarantees can be used for start-up ventures; to purchase an existing business; or to finance working capital, inventory, leasehold improvements, furniture and fixtures, equipment, real estate, and construction.

The SBA has several different types of loan guarantees and programs for small businesses with special needs. These programs are designed to help veterans, companies involved in international trade, technology firms, and designated geographic areas with low and moderate income. Programs include:

Program	Maximum Loan Amount	Percent of Guaranty	Use of Proceeds	Maturity	Maximum Interest Rates	Guaranty Fees	Who Qualifies	Benefits to Borrowers
7(a) Loans	$5 million gross	85% guaranty for loans of $150,000 or less; 75% guaranty for loans greater than $150,000 (up to $3.75 million maximum guaranty)	Term Loan. Expansion/renovation; new construction, purchase land or buildings; purchase equipment, fixtures, leasehold improvements; working capital; refinance debt for compelling reasons; seasonal line of credit, inventory	Depends on ability to repay. Generally, working capital and machinery and equipment (not to exceed life of equipment) is 5-10 years; real estate is 25 years.	**Loans less than 7 years:** $0-$25,000 Prime + 4.25% $25,001-$50,000 Prime + 3.25% Over $50,000 Prime + 2.25% **Loans 7 years or longer:** $0-$25,000 prime + 4.75% $25,001-$50,000 Prime + 3.75% Over $50,000 Prime + 2.75%	(Fee charged on guarantied portion of loan only) Maturity: 1 year or less 0.25% guaranty fee; over 1 year. $150,000 gross amount or less = 2.0%; $150,001-$700,000 = 3.0%; over $700,000 = 3.5%; 3.75% on guaranty portion over $1 million. Ongoing fee of 0.55%.	Must be a for profit business and meet SBA size standards; show good character, credit, management, and ability to repay. Must be an eligible type of business. Prepayment penalty for loans with maturities of 15 years or more if prepaid during first 3 years (5% year 1, 3% year 2, and 1% year 3)	Long-term financing; Improved cash flow; Fixed maturity; No balloons; No prepayment penalty (under 15 years)
SBA*Express*	$350,000	50%	May be used for revolving lines of credit (up to 7 year maturity) or for a term loan (same as 7(a)).	Up to 7 years for Revolving Lines of Credit including term out period. Otherwise same as 7(a).	Loans $50,000 or less; prime + 6.5%. Loans over $50,000; prime + 4.5%	Same as 7(a)	Same as 7(a)	Fast turnaround; Streamlined process Easy-to-use line of credit
Patriot *Express*	$500,000	Same as 7(a)	Same As SBA*Express*	Same as SBA*Express*	Same as 7(a)	Same as 7(a)	Same as 7(a). In addition, small business must be owned and controlled by one or more of the following groups: veteran, active-duty military, reservist or National Guard member or a spouse of any of these groups, or a widowed spouse of a service member or veteran who died during service, or of a service-connected disability.	High maximum amount and lower maximum interest rate than SBA*Express*; Fast turnaround; Streamlined process Easy-to-use line of credit
CapLines: 1. Working Capital; 2. Contract; 3. Seasonal; and 4. Builders CAPLines	$5 million	Same as 7(a)	Finance seasonal and/or short term working capital needs; cost to perform; construction costs; advanced against existing inventory and receivables; consolidation of short-term debts. May be revolving.	Up to 10 years, except Builder's CAPLine, which is 5 years.	Same as 7(a)	Same as 7(a)	Same as 7(a), plus all lenders must execute Form 750 and 750B (short term loans)	1. Working Capital - Revolving Line of Credit (LOC) 2. Contract - can finance all costs (excluding profit). 3. Seasonal - Seasonal working capital needs. 4. Builder - Finances direct costs with building a commercial or residential structure
Small/Rural Lender Advantage Loan (S/RLA) Average of 20 or fewer SBA loans annually over the last 3 fiscal years	$350,000	Same as 7(a)	Same as 7(a)	Same as 7(a)	Same as 7(a)	Same as 7(a)	Same as 7(a)	Same as 7(a) Plus streamlined process
Small Loan Advantage (SLA) Lender must be in Preferred Lender Program (PLP)	$250,000	Same as 7(a)	Same as 7(a)	Same as 7(a)	Same as 7(a)	Same as 7(a)	Same as 7(a)	Same as 7(a) Plus streamlined process
Community Advantage Mission focused lenders only	$250,000	Same as 7(a)	Same as 7(a)	Same as 7(a)	Prime plus 4%	Same as 7(a)	Same as 7(a)	Same as 7(a) Plus lenders must be CDFIs, CDCs or micro-lender targeting under served market

Program	Maximum Loan Amount	Percent of Guaranty	Use of Proceeds	Maturity	Maximum Interest Rates	Guaranty Fees	Who Qualifies	Benefits to Borrowers
International Trade	$5 million	90% guaranty (up to $4.5 million maximum guaranty) (Up to $4 million maximum guaranty for working capital)	Term loan for permanent working capital, equipment, facilities, land and buildings and debt refinance related to international trade	Up to 28 years	Same as 7(a)	Same as 7(a)	Same as 7(a), plus engaged/preparing to engage in international trade/adversely affected by competition from imports	Long term financing to allow small business to compete more effectively in the international marketplace
Export Working Capital Program	$5 million	90% guaranty (up to $4.5 million maximum guaranty)	Short-term, working capital loans for exporters. May be transaction-based or asset-based. Can also support standby letters of credit	Generally one year or less, may go up to 3 years	No SBA maximum interest rate cap, but SBA monitors for reasonableness	Same as 7(a)	Same as 7(a), plus need short-term working capital for exporting	Additional working capital to increase export sales without disrupting domestic financing and business plan
Export *Express*	$500,000	90% guaranty for loans of $350,000 or less. 75% guaranty for loans greater than $350,000.	Same as SBA*Express* plus standby letters of credit	Same as SBA*Express*	Same as SBA*Express*	Same as 7(a)	Applicant must demonstrate that loan will enable them to enter a new, or expand in an existing export market. Business must have been in operation for at least 12 months (though not necessarily in exporting).	Fast turnaround; streamlined process; easy-to-use line of credit
Dealer Floor Plan	$5 million maximum $500,000 minimum	Same as 7(a). 100% advance on both new or used inventory that can be titled	Qualifying small businesses, including boats, automobiles, motorcycles, manufactured homes and RV dealers. Can refinance an existing dealer floor plan	Minimum 1 year Maximum 5 years	Same as 7(a). Interest paid monthly on outstanding balance	Same as 7(a) with the exception of the extraordinary servicing fee (fee cannot be greater than non-SBA loan fee)	Same as 7(a)	Reasonable financing
504 Loans Provided through Certified Development Companies (CDCs) which are licensed by SBA	504 CDC maximum amount ranges from $5 million to $5.5 million, depending on type of business.	Project costs financed as follows: CDC: up to 40% non-guaranteed financing: Lender: 50% Equity: 10% plus additional 5% if new business and/or 5% if special use property.	Loan-term, fixed-asset loans; lender (non-guaranteed) financing secured by first lien on project assets. CDC loan provided from SBA 100% guaranteed debenture sold to investors at fixed rate secured by 2nd lien	CDC Loan: 10- or 20-year term fixed interest rate. Lender Loan: (unguaranteed) financing may have a shorter term. May be fixed or adjustable interest rate	Fixed rate on 504 Loan established when debenture backing loan is sold. Declining prepayment penalty for 1/2 of term	.5% fee on lender share, plus CDC may charge up to 1.5% on their share. CDC charges a monthly servicing fee of 0.625%-1.5% on unpaid balance. Ongoing guarantee fee (FY 2012) is 0.9375% of principal outstanding. Ongoing fee % does not change during term.	Alternative Size Standard: For profit businesses that do not exceed $15 million in tangible net worth and do not have an average two full fiscal year net income over $5 million. Owner Occupied 51% for existing or 60% for new construction	Low down payment - equity (10%-20%) (The equity contribution may be borrowed) Fees can be financed SBA Portion: Long-term fixed rate Full amortization No balloons
504 Debt Refinance Provided through CDCs which are licensed by SBA. The refinance program will be in effect through September 27, 2012.	Same as 504 plus 85% or more of the proceeds of existing debt or 85% of original loan had to be for eligible fixed assets.	The remaining 15% was incurred for the benefit of the small business	Same as 504. Cash out equity for working capital or other eligible business expenses up to 18 months in advance. Can finance up to 90% of the current appraised property value between CDC and lender	Same as 504	Same as 504	Same as 504 with the exception that the ongoing fee is (FY 2012) 1.103%	Same as 504 plus borrower must have been current on last 12 monthly payments. Cannot refinance an existing federal government loan	Business owner may be able to refinance property that is under-collateralized with the addition of cash, other property or other options worked out with lender. Can also finance 504 eligible refinancing costs
Non-7(a) Loans Microloans Loans through nonprofit lending organizations; technical assistance also provided.	$50,000	Not applicable	Purchase machinery & equipment, fixtures, leasehold improvements; finance increased receivables; working capital. Cannot be used to repay existing debt	Shortest term possible, not to exceed 6 years	Negotiable with intermediary. Subject to either 7.75 or 8.5% above intermediary cost of funds	No guaranty fee	Same as 7(a)	Direct loans from non-profit intermediary lenders; Fixed-rate financing; Very small loan amounts; Technical assistance available

*For more details on these SBA programs, visit their web site at www.sba.gov.

List of Documentation Requirements

DOCUMENTS REQUIRED FOR START-UP BUSINESS LOAN PROPOSALS

(Items may differ for types of businesses and lenders)

1. Personal financial statement of each owner; no older than 90 days. Lender provides forms.

2. Description of the business venture.

3. Project cost with bids and quotes. If applicable, quotes on construction (include architect and engineering fees) or renovations, leasehold improvements, machinery and equipment, inventory.

4. For SBA guarantees and loan programs, statement of personal history for each borrower, officer (if incorporated), and partner (if partnership). (SBA Form 912)

5. Resume for each of the above as well as for other key personnel.

6. Projected balance sheet and profit and loss for at least the first two years.

7. Projected monthly cash flow for the first two years (can use SBA Form 1100).

8. If franchise, franchise agreement. SBA checks (www.franchiseregistry.com) to see if the franchise is approved.

9. Employment details. For guarantee and other government loan programs, break down employment total into current and projected minority, male, and female employees.

10. Sales contracts or lease agreements if applicable.

11. Appraisal acceptable to lender and/or intermediary.

12. If corporation, Articles of Incorporation.

13. Last three years' personal tax returns.

14. If applicable, environmental impact studies (ex. soil testing, wetlands, wildlife).

15. Detailed business plan that contains company, product, market, promotion, competition, and personnel information. Most business plans contain most items above.

For more information on loan proposals and loan requirements, review UGA SBDC Publication, *Mastering Business Loan Proposals: A Guide to Understanding Banking Expectations, Types of Loans, and Business Plans.*

Grants

If you are looking for grants to finance your business, you are bound to be discouraged very early. Very few grants exist for small businesses, especially for start-up businesses. In fact, if your business is a common type of business, such as a florist, it is nearly impossible to find a grant that will meet your business's needs. State agencies, municipalities, and non-profit corporations administer the few grant programs that can be used for small business activities. As mentioned before, these groups form revolving loan fund programs for small businesses from these grants.

Although grants for common retail and service businesses are rare, grants are available to companies that are developing new technologies. SBA and several Federal departments participate in the Small Business Innovation Research Program (SBIR) and the Small Business Technology Transfer Program (STTR). These programs provide grants up to $500,000 for research and development. Some departments such as the Department of Energy provide their own grants to technology companies.

Additionally, grants are available to businesses that meet specific social needs. For example, the Georgia Childcare Council has provided grants to child daycare centers that develop special programs for children with learning and behavior disorders. Agencies on aging have also provided grants to businesses that had adult daycare programs assisting people with Alzheimer's or severe handicaps.

Grants for businesses typically require a 1:1 match. For every dollar put into the business, the business is required to contribute an equal amount. Businesses that are pursuing grants will need to find a Request for Proposals (RFP) that will fit their business. RFP's require project descriptions and budgets; some may require a business plan with financial statements. Once a business receives a grant, comprehensive documentation on expenditures is required.

www.georgiasbdc.org

CHAPTER SIX: LEGAL AND RISK MANAGEMENT ISSUES

Once a person decides to start a business, several decisions must be made regarding how to protect that business. By operating within the letter of the law and insuring against unforeseen circumstances, a business will be poised for long-term growth. In this section of the guidebook legal issues and risk management are discussed; however, this is by no means an all inclusive discussion, and you should seek further advice from an attorney and insurance agent regarding your own specific situation.

Choosing a Legal Form of Business

A primary decision when starting a new business is the determination of the appropriate legal structure for that business. Several factors must be considered when making this decision including the number of business owners, the type of business, liability exposure, taxes, and future expansion plans.

SOLE PROPRIETORSHIP

The sole proprietorship is the most popular type of business organization in the United States, and it is the easiest form to operate because it does not require any specific legal organization beyond the normal requirements such as licenses or permits. A sole proprietorship is a for-profit concern owned and operated by one individual or by a husband and wife, but it may have many employees. A sole proprietorship is not considered to be a separate legal entity under the law, but rather an extension of the individual who owns it. The owner possesses the business assets and is directly responsible for all debts and other liabilities incurred by the business. For tax purposes, the profits or losses of the sole proprietorship are combined with the personal income of the business owner (For business taxes use *Federal Tax Form 1040, Schedule C*. The results are then transferred to the appropriate personal income tax form. Note: *Schedule SE* should also be filed for Social Security taxes.)

Advantages:

- Less formality and fewer legal restrictions than any other form of legal structure
- Less governmental approval or restrictions, depending on the type of business
- All profits go directly to owner
- Flexibility: decision making controlled by one owner; quicker response time
- Taxation at owner's personal tax rates
- Net profit or loss is figured separately from owner's primary income and is added to or subtracted from the owner's personal taxable income

Disadvantages:

- Owner is personally responsible for the total amount of business debts beyond the owner's total investment, extending to the owner's personal assets (i.e., houses, cars)
- Relative difficulty in obtaining financing
- High tax rates if the business is successful
- The abilities and commitment of the sole owner can limit growth capacity
- When the owner dies, the business ceases to exist as a legal entity

PARTNERSHIP

A partnership is often used when a combination of skill sets by two or more people is required to operate a business. This form of organization is also considered to be a good option when product liability issues are not of great concern for the business. Partnerships can take two legal forms: general or limited. In a general partnership, the owners work together to manage and finance a business. Both share in the business's debts and profits as a result of the capital, labor, property or skills contributed. A limited partnership (sometimes referred to as LP's or LLP's) consists of one or more general partners who manage the business and are personally liable for partnership debts and one or more limited partners who risk an investment in the business in anticipation of a share in its profits. The limited partners do not manage the business and are not liable for the debts of the partnership business beyond the amount invested in the business. Firms that invest in real estate or speculative ventures often use limited partnerships.[2] Georgians wishing to form a limited partnership must file a Certificate of Limited Partnership with the Georgia Secretary of State's office. Additionally, limited partnerships must file an annual registration with the Georgia Secretary of State's office in the first quarter of every calendar year.[3] Specific instructions and fee amounts can be found at www.georgiacorporations.org.

The rights, responsibilities, and obligations of both the limited and the general partners are typically detailed in a partnership agreement. A notarized agreement will specify the financial, managerial, and material contributions by each partner.[4] Partnership agreements typically include the following:

[2] Pinson, Linda. *Steps to Small Business Start Up: Everything You Need to Know to Turn Your Idea Into a Successful Business (Small Business Strategies Series).* Out of Your Mind...And Into The Mark. (2014)
[3] Jenkins, Michael D. Thomas J. Harrold, Jr. and Neill Edwards. *Starting and Operating a Business in Georgia: A Step by Step Guide*. Oasis Press/PSI Research (Granmts Pass, Oregon: 1995) Chap. 11, pp. 5.
[4] Pinson, Linda and Jerry Jinnett. *Steps to Small Business Start Up: Everything You Need to Know to Turn Your Idea Ito a Successful Business (Small Business Strategies Series).* Out of Your Mind...And Into The Mark. (2014)

- Name, purpose, and length of the agreement
- Contributions of the partners
- Participation of the partners (general or limited, active or silent)
- Authority, management, decision making
- Divisions of profits and losses, withdrawals
- Method of accounting
- Source of partnership interest
- Release of debts and responsibility
- Death of partner, absence, disability
- Dissolution
- Settlement of disputes
- Additions, alternations, and modifications

A partnership is a separate legal entity with various rights and responsibilities. A partnership can hire employees, own property, sign contracts, obtain trade credit, and borrow money, although most creditors require a personal guarantee from the partners. A partnership is also required to *file* income tax returns for both federal and state purposes (*Form 1065* is the Federal form and *Form 700* is the Georgia form.) A partnership typically does *not pay* income tax, but the information for the tax return is combined with the personal income of the partners (*Schedule E* of *Form 1040)*.

Advantages:

- Losses and investment tax credits can be passed through to partners
- Less documentation required to form as compared to corporations
- Direct rewards based on ownership percentage
- Flexibility, but less than a proprietorship
- Less governmental control and special taxation issues as compared to corporations
- Diversity of skills, sharing of workload, access to capital and ideas could be useful to the success of the business
- Limited partnerships provide a potential for a return on investment, but with limited risk

Disadvantages:

- Unlimited liability of general partners
- Loss of any partner constitutes an automatic dissolution of the entire partnership

- Relative difficulty in obtaining capital, as all investors are considered partners
- Business is bound by acts of just one partner as agent regardless of wishes of other partners
- Dissolution of partnership must be defined in partnership agreement

CORPORATION

Corporations are the most expensive and complex form of legal structure a business may adopt. A corporation is a separate entity which exists under the authority of the state and approval by the Secretary of the State. A corporation is a legal entity apart from its owners and can transact business, enter into contracts, and sue or be sued. If it conducts interstate commerce, then it must abide by pertinent federal laws regulating such. A corporation must also adopt and file articles of incorporation that usually cover the purpose or mission of the business, its name, directors' qualifications, location, and proposed capital structure. An annual registration with the Secretary of State's office must also be submitted each year (January 1 – April 1) that the corporation conducts business in Georgia. The forms, fee amounts, and instructions for these filings can be found at the Secretary of State's web site www.georgiacorporations.org.

Corporations must file annual income tax returns with the IRS and with all states in which they do business. Generally, the owners or shareholders of the corporation are protected from the liabilities of the business, but when the corporation is small, creditors often require personal guarantees of the principal owners before extending credit.

The additional expense of starting and administering a corporation is generally regarded as a small price to pay for the extended legal protection obtained by the owners of a corporation. Incorporating a business allows a number of other benefits such as the ability to raise additional capital through the sale of equity (stock) and the limited liability of all owners in the business. The corporate structure also enables a business to continue operating when the original owners choose to retire or are unable to continue participating in the business.

Advantages:

- Stockholders' liability is limited to a fixed amount of investment
- Separates the legal existence of corporation from personal existence for tax purposes
- Ownership is transferable via the sale of stock

- Stability and relative permanence of entity
- Ease of securing capital through the issuing of stock

Disadvantages:

- Activities regulated by government
- Potential for manipulation by large volume stockholders
- Required local, state, and federal reporting
- Double taxation: corporate net income is taxed at the corporate tax rate and stockholders' dividends are taxed as personal income (C-corporation only)
- Generally more expensive to set-up and operate than sole proprietorship or partnership

Contact:
Georgia Secretary of State
Corporations Division
315 West Tower
2 Martin Luther King Jr. Drive SE
Atlanta, GA 30334
404-656-2817
https://ecorp.sos.ga.gov

S CORPORATION

A domestic corporation that is owned by no more than 100 shareholders, has only one class of stock, and does not own more than 80 percent of another corporation may elect to apply for designation as a Sub-Chapter S Corporation with the Internal Revenue Service. The S Corporation is granted the same rights and responsibilities as a corporation, but is subject to different tax treatment by the Internal Revenue Service (IRS). A corporation must file for S Corporation status by the 15th day of the third month after incorporating by submitting *Form 2553* to the IRS.

Advantages:

- Elimination of corporate double taxation
- Losses are deductible by stockholders
- Limits personal liability
- Ownership is transferable via sale of stock
- Investment tax credits pass through to stockholders
- Continuity of business

- Owners can participate in the management of S Corporation

Disadvantages:

- Passive investment income cannot be more than 25 percent of gross receipts for each of three consecutive years
- Some states don't recognize S Corporations (Georgia does recognize S Corporations)
- Must meet eligibility requirements
- No corporations or nonresident aliens may be shareholders
- Can offer only one class of stock and the number of stockholders cannot exceed 100

LIMITED LIABILITY COMPANY

A Limited Liability Company (LLC) is a hybrid form of organization which combines the beneficial tax status and flexibility of a partnership along with the limited liability protection afforded by a corporation. An LLC is generally owned by two or more interest-holders called members. An LLC is formed by reserving a name and delivering articles of organization to the Secretary of State for filing. These articles provide information similar to that of a corporation's articles of incorporation.

Management of the company is vested in a manager or managers. The manager may or may not be a member. Members of an LLC can include individuals, corporations, partnerships, trusts, other LLCs, and other entities. LLCs generally are required to have at least two members when they are formed, although Georgia allows one-member LLCs.

Advantages:

- Unlike an S Corporation, there is no limitation on number or types of members
- Recognized as a separate legal entity
- Shields personal assets of members just as though they were stockholders in a corporation
- Able to offer different classes of stock
- Eliminates double taxation which corporate stockholders pay
- Losses are deductible by members
- Profits may be allocated based on factors other than percentage of stock ownership
- Achieves goals of limited liability and pass-through tax treatment with fewer restrictions than any other form of business entity

Choosing a Legal Form of Business

- Owners can participate in the management of an LLC

Disadvantages:

- The LLC may not be well-suited to multi-state operations. Many states have not adopted LLC statutes and provisions for "foreign" LLCs, so the limited liability of Georgia LLCs may not be honored in other states that tax the LLC like a corporation
- It may be difficult to convert from a corporation to an LLC without negative tax consequences
- Depending on the wording of the operating agreement, there may be no free transferability of interests
- Depending on the wording of the operating agreement, the LLC may not have perpetual life; an LLC is limited to 30 years in Georgia
- Professional legal and accounting assistance is strongly recommended

Compliance Issues

Businesses have different requirements regarding zoning, licensing, permits, insurance, and taxes. (Note: Taxation requirements are also covered in the next chapter entitled "Financial Record Keeping.")

PLANNING AND ZONING

Zoning: Before you purchase or lease a facility, you should check with the local/county planning authorities regarding the zoning of your property, parking area, and signage allowed for your business. Planning authorities also regulate home-based business operations.

Certificate of Occupancy: The local Fire Marshall should inspect the building for fire code compliance before it is put to use.

Certificate of Building Inspection: The local building inspector certifies proper use of accesses, restrooms, and construction types.

LICENSES

Every business must have proper business licenses. The business license is also called a "business tax certificate" or an "occupational tax permit." Business licenses are obtained at city hall, the county courthouse, or administration building for the city or county in which your place of business is located. You should check with every county in which you conduct business for its business license requirements and applicable fees.

TRADE NAME

All businesses organized as sole proprietorships or partnerships that operate under a name that does not reflect ownership should file a trade name (fictitious name) registration with the Clerk of Superior Court of the county where the business is located. For example, an ice cream shop owned by Joe Smith would register as "Joe Smith's Ice Cream Shop Doing Business as The Corner Creamery."

PERMITS

Over 30 types of businesses are subject to special permits, licenses, and inspections. These include schools, employment agencies, child care centers, securities dealers, motor transport, financial institutions, public entertainment, detective agencies, cosmetologists, heating and air, refrigeration, plumbers, and electricians. Information about licensing, permits, and inspections can be found through your local licensing or inspection office or at the following web site: www.sos.state.ga.us/plb

Food Handling & Distribution: Under law, any business engaged in the processing, handling, storage, or distribution of food products should apply for a permit from:

Georgia Department of Agriculture
Consumer Protection Division
19 Martin Luther King Jr. Dr., SW
Room 242
Atlanta, GA 30334
404-656-3641/800-282-5852

www.agr.georgia.gov

Cooking & Preparation of Food: Businesses that engage in the cooking or preparation of food to be served (restaurants, hotels, nursing homes, etc.) should be inspected and licensed by the local county health department.

Liquor License: Businesses wishing to serve alcoholic beverages must apply for a license. Check with your city license and tax department or county finance department for procedures.

Compliance Issues

TRADEMARKS, SERVICE MARKS, PATENTS, COPYRIGHTS

A trademark is defined as any word, name, symbol, device, or combination thereof adopted and used by a person or entity to identify goods made or sold and to distinguish them from goods made or sold by another person or entity. Similarly, a service mark is used by a person or entity to identify services rendered or offered and to distinguish them from services rendered or offered by another person or entity. Trademarks, service marks, and patents may be registered for legal protection. Information and applications can be obtained from:

Trademarks/Service Marks
Secretary of State
Corporations Division
404-656-2861
http://sos.ga.gov/index.php/corporations/search_the_trademarks_and_service_mark_database

Patents are granted by the U.S. Government to an inventor "to exclude others from making, using, offering for sale, or selling the invention throughout the United States or importing the invention into the United States" for a limited time in exchange for public disclosure of the invention when the patent is granted. Publications concerning patent laws, trademarks, and inventions are available at the Federal Bookstore and the U. S. Department of Commerce. You may wish to consult with a patent attorney. Patents are registered at:

U. S. Department of Commerce
Patent and Trademark Office
1-800-786-9199

www.uspto.gov

Copyright is a form of protection provided by U.S. laws to authors of original works. Copyright forms and information are available from the Library of Congress:

Copyright Office
Library of Congress
101 Independence Avenue NE
Washington, DC 20559
202-707-3000 for forms and public information

www.copyright.gov

BULK SALES LAW

If you plan to purchase an established business, you as the purchaser must comply with the Bulk Sales Law. It is required that at least five days before the actual purchase, each creditor must be notified personally of the proposed sale. In counties of over 200,000 population, it is necessary to publish this intent to purchase one time, not less than seven days prior to completion of the purchase. Consult your attorney about this procedure.

SALES & USE TAX

Businesses that sell retail or wholesale products or provide certain types of services are required to collect and remit sales tax on behalf of the state. You must apply to the state of Georgia for a sales tax number which will be sent to you with instructions for collecting, reporting, and remitting tax monies to the State.

Georgia Department of Revenue
Sales and Use Tax Division
P.O. Box 105296
Atlanta, GA 30348-5296
404-417-4477
https://dor.georgia.gov/

PROPERTY TAX

All businesses operating in Georgia are required to pay property (ad valorem) taxes on the real property and personal property of the business. Real property is land and anything that is growing, erected, or affixed to the land. Personal property is everything that can be owned that is not real estate (i.e., equipment, vehicles). Property taxes are assessed and collected by the individual counties. Therefore, business owners must contact the tax assessor's office in the county in which the business is located to determine appropriate rates and obtain forms. The Georgia Department of Revenue web site has links to local tax offices through the State Property Tax Division.

Georgia Department of Revenue
Property Tax Division
4245 International Parkway
Hapeville, GA 30354-3903
404-968-0480
https://dor.georgia/gov/

Compliance Issues

BUSINESS INCOME TAX

Business income taxes are paid at both the federal and state levels. The forms required depend on your business entity. The Internal Revenue Service and the Georgia Department of Revenue have publications that will assist in planning for income tax filing requirements. More information can be found in Chapter 7 of this guidebook.

EMPLOYMENT ISSUES

Business owners with employees are required to register with a number of different state and federal agencies. Employers are also responsible for withholding and remitting taxes on behalf of their employees. Tax requirements, insurance requirements, citizenship verification, and other employee-related compliance issues are discussed below.

SS-4 Federal Tax ID Number

If your legal form is a corporation, a limited liability company, a partnership, or if you have employees, you need a Federal Tax ID number. A completed *Form SS-4* should be submitted to the Internal Revenue Service. This number is used to identify and deposit Federal income taxes and Social Security taxes on behalf of your employees.

Internal Revenue Service
Taxpayer Educational Services Division
401 W. Peachtree Street, NW
Atlanta, GA 30365
1-800-829-4933 for forms

www.irs.gov

W-4 Employees Withholding Allowance Certificate

All employees need to complete a W-4 Form. The W-4 Form instructs the employer how many exemptions to include when calculating the federal income tax withholdings. These forms remain in your employees' personnel files and are not mailed to the IRS. Forms may be obtained from:

Internal Revenue Service
1-800-829-3676

www.irs.gov

W-2 Wage and Tax Statement

Employers must file Form W-2 for wages paid to each employee from whom income, social security, or medicare taxes were withheld. Also, Form W-2 must be completed for employees from whom income taxes would have been withheld if the employee had claimed no more than one withholding allowance or had not claimed exemption from withholding on Form W-4. Further details are available on the IRS web site.

940 Employer's Annual Federal Unemployment Tax Act (FUTA) Return

Employers with one or more employees are required to prepare and file this return. Employers pay unemployment on behalf of their employees at a rate of 0.8 percent of the first $7,000 of wages paid to an employee in one year. This tax must be paid quarterly, and at the end of each year you must file *IRS Form 940* or *Form 940EZ*, Employers Annual Federal Unemployment Tax Return.

941 Employer's Quarterly Federal Tax Return

Federal withholding and FICA deposits are reconciled on *IRS Form 941* quarterly tax return. FICA is calculated on the basis of employee salary. Employees have 1.45 percent for Medicare and 6.2 percent (for 2012, 4.2 percent due to FICA withholding percentages being temporarily changed by Congress) for Social Security withheld from their salaries, and employers must still pay 6.2 percent. Contact the IRS for a *Circular E* regarding employee withholding or consult your tax professionals.

Internal Revenue Service
1-800-829-3676

www.irs.gov

State of Georgia Withholding Number

All employers are required to have a State withholding number. This number is used to identify and deposit State of Georgia income tax withheld from employee checks.

Georgia Department of Revenue
Income Tax Division
P. O. Box 38487
Atlanta, GA 30334
404-417-4480

www.dor.ga.gov

Compliance Issues

G-4 Employees Withholding Allowance Certificate

All employees need to complete a *G-4 Form*, which is held in employee files and not mailed to the Department of Revenue. The G-4 Form instructs the employer how many exemptions to include when calculating the state income tax withholdings. Forms may be obtained from:

Georgia Department of Revenue
Income Tax Division
P. O. Box 38487
Atlanta, GA 30334
404-417-4480

www.dor.ga.gov

G-7 Quarterly Reconciliation Return

Withholding filing requirements are based on the amount of taxes that were withheld for the previous 12-month period ending June 30. Consult the Georgia Tax Guide to determine whether your business should file annually, quarterly, monthly, or semi-weekly.

DOL-1A State Unemployment Application

All employers are required to have a Georgia Department of Labor Number in order to pay State Unemployment Insurance on behalf of their employees. Applications are available on-line or through your local Department of Labor office.

www.dol.state.ga.us

DOL-4N State Unemployment Tax Act (SUTA)

Georgia unemployment insurance for new employers is 2.7 percent of the first $8,500 paid to an employee in one year, paid by the employer. The Employer Quarterly Report (*Form DOL-4N*) is required.

www.dol.state.ga.us

Employer New Hire Reporting Program

All employers are required to report new hires to the State. This information is used to identify employees who are delinquent in child support payments.

New Hire Reporting Program
P. O. Box 38480
Atlanta, GA 30334-0480
1-888-541-0469
404-525-2985

www.ga-newhirereporting.com/ga-newhire

I-9 Citizenship Verification

Employees must be verified for U.S. Citizenship. U.S. Immigration and Naturalization Services *Form I-9* must be filled out by each employee and kept on file by the employer with the appropriate documentation attached.

U.S. Immigration & Naturalization Services
1-800-375-5283

www.uscis.gov

Minimum Wage

A Small Business Resource Guide is available from the U.S. Department of Labor. This guide contains information on overtime, minimum wage, and other relevant employee benefit issues. Even if you don't fall under federal minimum wage law, you are still subject to Georgia minimum wage law requirements. Contact your local U.S. Department of Labor representative or:

U. S. Department of Labor	Georgia Department of Labor
www.dol.gov	www.dol.state.ga.us

Worker's Compensation Insurance

Employers with three or more employees are required by law to carry Worker's Compensation Insurance. This insurance is regulated by the State but sold by local community insurance agents. A minimum of three quotes is recommended. Owners that work in the business are considered employees but can exempt themselves from worker's compensation insurance coverage.

State of Georgia
State Board of Worker's Compensation
270 Peachtree Street, NW
Atlanta, GA 30303-1299
404-656-3875

www.sbwc.georgia.gov

Compliance Issues

Determination of Employment Status

Employers are often tempted to classify their workers as independent contractors to avoid the tax and reporting burden that comes with hiring employees. The Internal Revenue Service has a list of conditions that must be met in order to classify a worker as an independent contractor, as shown below. These conditions are based on the control a business has on an individual. When making a determination about a worker's status, you should consider the following questions:

- Will you tell someone when, where, and how to work?
- Will you train someone to perform services in a particular manner?
- Will the success or continuation of your business depend on the performance of certain services by a particular worker?
- Will that worker render services personally?
- Will you hire, supervise, and pay the workers?
- Will the worker have a continuing relationship with your business?
- Will you set the hours to be worked?
- Will you require the worker to devote full-time commitment to your business?
- Will the work be done on site, or in accordance with a route or at a location you designate?
- Will you determine the order or sequence in which services are to be performed?
- Will you require oral or written reports to be submitted?
- Will you pay a worker by the hour, week, or month rather than by the completion of a specific project?
- Will you pay travel and business expenses?
- Will you furnish tools, materials, and other equipment?
- Will the worker be able to perform his/her required tasks without making an investment in your business?
- Will the worker NOT make a profit or suffer a loss from your business?
- Will the worker normally work for only one (YOUR) business at a time?
- Will the services performed be made available to your business only?
- Will you have the right to fire the worker?
- Will the worker have the right to quit without incurring liability?

If you answer yes to all or most of these questions, your workers may be employees rather than independent contractors. For more information on independent contractors, please consult with the Internal Revenue Service or your tax professional.

Risk Management and Insurance

Starting a business is risky. A new business owner needs peace of mind when it comes to protecting the business assets from potential losses. Business owners have several options when contemplating risk management:

- Prevent a loss from occurring
  A business owner can prevent an employee or customer from tripping by removing all obstructions in walkways of the business. Case in point: electrical cords should be properly secured and out of the walkways. Employee training that stresses on-the-job safety, technical competence, and proper business behavior (acting in an ethical, non-harassing manner) can prevent potential accidents or lawsuits.

- Reduce the severity of a loss that is not preventable
  A business owner who installs metal bars over window areas may prevent someone from entering the premises, but will not prevent someone from throwing an object between the bars and breaking the windowpanes. Security systems (alarms, pass codes, and guards) can help deter and/or minimize theft risks. Also, up-to-date duplicate records should be kept off site in case of fire or other natural disasters. In addition to protecting physical property, intellectual property should be protected through the use of patents, trademarks, and service marks.

- Absorb the cost of a loss using company assets
  If debris falls from a business's truck and cracks the windshield of another vehicle, the business can replace the windshield using company resources (funds).

- Transfer the risk of a loss to a third party by purchasing insurance
  A business owner purchases a property policy for his store's building and business contents. If a tornado causes severe damage to the building and its contents, the business owner would receive proceeds as outlined in the insurance policy to rebuild the building and replace the contents. The actual amount of proceeds would depend on the policy limits, terms, and conditions.

There are many, many types of business insurance available. Some of the more common types are described in the following table. All policies are not necessary for every business. You must decide what is most critical to your specific business, that is, how much risk your business can accommodate and remain viable. Once the types of necessary insurance have been decided, you should consider the degree of coverage versus the cost of that coverage.

Risk Management and Insurance

Type of Insurance	Description
Commercial Property	Includes coverage for building, business personal property, personal property of others, and loss of business income. Property can be valued at replacement cost (usually the better option) or depreciated settlements.
Commercial General Liability	This coverage is sometimes referred to as “public liability.” This product provides protection to third parties that may be insured as a result of your business operation. This insurance takes effect when someone slips on the sidewalk in front of your business or when someone claims your employees were negligent in installing a light fixture and a fire subsequently happens, and the cause is determined to be faulty wiring.
Business Owner Policy	A combination of commercial property and liability tailored specifically for certain types of small businesses. This usually includes commercial property and commercial general liability coverage, but excludes professional liability.
Commercial Inland Marine	Includes coverage for mobile equipment, computer equipment, buildings under construction, cargo being hauled/towed, and bailees coverage. Bailees coverage would be needed for any type of business that accepts goods of customers for repair or cleaning such as a dry cleaner or jewelry repair shop.
Commercial Automobile	Includes coverage for liability, medical payments, uninsured motorists, physical damage coverage, towing, and rental car reimbursement. This coverage is for vehicles owned by the business and listed on the policy. Also, coverage can be provided for vehicles that are leased, hired, or borrowed. For example, your company could be liable if an employee uses his personal vehicle to run errands for the company and the employee has an accident during this time.
Garage and Dealers Coverage	Includes garage liability, dealers’ physical damage, and garage keepers’ coverage. This policy is a combination of Commercial General Liability and Commercial Automobile policies and is designed for specific types of businesses. This coverage is usually written on automobile repair shops, automobile dealers, etc.

Type of Insurance	Description
Commercial Umbrella Liability	Includes an extra layer of liability coverage over and above your Commercial General Liability, Commercial Automobile Liability, Garage Liability, and Employers' Liability. For example, a business with a $1,000,000 limit of Umbrella Liability would have a limit of $2,000,000 available for each covered claim. Also, the umbrella policy can, in some cases, provide primary coverage for certain types of claims that may not be covered by the first layer of coverage. In this case, the policy contains a large deductible, usually in the amount of $10,000.
Workers Compensation	Includes Employers' Liability and Statutory Benefits. This coverage is required in the state of Georgia for any employer who has three or more employees. The owner may be counted as one of the three employees depending upon the legal form of the business. The rates are structured to coincide with the specific duties of an employee. For example, a clerical worker is not exposed to the same hazards in the workplace as a roofing contractor, and, therefore, the rate for the clerical worker is very low compared to the rate for the roofing contractor.
Other Policies	Includes Boiler & Machinery, Directors & Officers, Key-Man, Professional Liability (Errors & Omissions), Commercial Crime, Lease-Hold, Extra Expense, Business Interruption, Convention Cancellation, Glass and Sign, Accounts Receivable, and Valuable Papers.

Some companies sell insurance directly to their business clients, but many insurers utilize a network of agents and brokers to market their products. To find an agent you can feel comfortable with and trust, ask for referrals from other business owners, preferably in your same industry, or check with your local chamber of commerce or SBDC office. One credential to look for when selecting an agent or broker is to identify whether he/she has earned any certifications. Some common designations include CPCU (Chartered Property Casualty Underwriter), CIC (Certified Insurance Counselor), AAI (Accredited Advisor in Insurance), or ARM (Associate in Risk Management).[5] When an owner is deciding what types of insurance to purchase, agents can be of great assistance in explaining the technicalities of various programs and policies (i.e., waiting periods, co-insurance levels, allowable charges, policy maximums, and war clauses). Talking to other business owners in the same industry about their insurance programs and checking with trade associations for special programs available to members can also prove beneficial.

[5]Chadderdon, Lisa. "Business Insurance: A 12-Point Checklist," Inc.com. October 1, 2001. Obtained August, 2002 from www.inc.com/articles/2001/10//23492.html.

Risk Management and Insurance

A new business owner should discuss the following with the insurance agent:

- *Claims procedures for your specific policies.* You will need to know what actions are required by you after a claim occurs. Some companies have specific procedures that must be followed or penalties will apply.
- *Payment plan options.* Most insurance companies now offer installment plans that can fit the budget of a small business and help with cash flow.
- *Relevant riders for your specific business.* For home-based businesses, sometimes riders can be added to the homeowner's policy to cover the business. Depending upon the insurer and the type of business, this alternative may be more affordable.
- *Additional services they provide to you as a client.* Most provide a number of services free of charge, but they don't always advertise this type of information. For example, some offer a 24-hour claims hotline.

Additionally, an agent should provide:

- Copies of your loss history each year about 90 days before your renewal date. The agent/company is required to provide these to you within 30 days of your request as mandated by a State of Georgia law. Ask for a three-year period so that you can keep updated on claims in previous years.
- Quotes from several different insurance companies, if possible. Ask to see a written copy of the quotes from all companies even if the agent tells you the premiums were higher than your current policies. Try to make an "apples to apples" comparison because lower premiums often result from less coverage.
- A written renewal quote at least 30 days prior to your renewal date. This allows you ample time to consider your options.

The Georgia Department of Insurance
www.gainsurance.org

The next chapter of this guidebook begins the application of many of the principles discussed so far and the resulting action the entrepreneur must take based on decisions about how to manage the business.

CHAPTER SEVEN: FINANCIAL RECORD KEEPING

Why Keep Financial Records?

Businesses record their financial transactions for three reasons. First, financial records are used to prepare reports and tax returns required by federal, state, or local governments. Second, businesses seeking capital will need to show their financial records to lenders or investors. Third, and most importantly, well-maintained financial records can be used by management to improve operations and profitability.

Most businesses understand the necessity of keeping financial records to comply with the law but overlook how these records can be used to improve business operations. The information generated by recording and monitoring financial transactions can help business owners and managers identify trends and potential problems and act on them to improve profits.

Selecting an Accounting Method

What type of tax accounting method and accounting system a company chooses depends on several factors, including the legal form of the business, the type of business, whether the business maintains inventory, or whether the business has employees.

ACCOUNTING METHODS

Generally, business owners choose between two accounting methods: the cash method and the accrual method. However, there are hybrid methods, sometimes referred to as "modified accrual" methods, that a business may choose when financial management is not conducive to the cash or accrual method. The method chosen for the business must be in compliance with Internal Revenue guidelines. Businesses are not allowed to switch methods of accounting from year to year, unless after filing the first tax return, it requests and receives Internal Revenue Service approval to change accounting methods. Request for approval to change accounting methods must be submitted on *Internal Revenue Service Form 3115*.

Cash Method

The cash method of accounting is preferred by many small businesses because it is the simplest to use and the easiest to learn. However, businesses with significant inventories, some corporations, and certain partnerships are prohibited from using the cash method of accounting. Under the new simplified accounting rules, most small service providers with average gross receipts up to $10 million will be able to use the cash method of accounting. The cash method is the simplest in that the books reflect the actual flow of cash in and out of the business. Income is reported when it is received and expenses are reported when they are paid.

Selecting an Accounting Method

Accrual Method

Most large businesses and businesses that maintain significant inventories use the accrual method of accounting. Under this method, income is reported in the year earned, not the year received. Expenses are reported in the year incurred, not when actually paid. The purpose of this method of accounting is to match both income and expenses in the year of occurrence, rather than the year of receipt.

Hybrid Methods

Hybrid accounting methods use a combination of the cash and accrual methods. A hybrid method of accounting is the best choice when there is a sound business reason; the business must use the same accounting system consistently from year to year. A hybrid method does not override other methods. For example, if a business maintains inventories, then the accrual method must determine the accurate cost of goods sold for the year. If sales are made on credit, then income and expenses must be recorded on the accrual method. An example of this method would be a small retail gift shop in which the clientele is cash and carry. The business carries several operating expenses on 60-day terms. However, it accounts for Cost of Goods Sold on the accrual basis and uses cash basis for the operating expenses, regardless of their terms.

LEGAL FORMS OF BUSINESS

As previously discussed, one of the first important decisions a business owner makes is the legal form of the business. The type of legal entity chosen will have tax and other legal implications and impacts how financial information is recorded and reported. It is beyond the scope of this guidebook to give a detailed account of what records are required for each entity. For more information on this subject, please refer to www.irs.gov, the web site of the Internal Revenue Service. For sole proprietorships, see *Publication 334*. For partnerships, see *Publication 541*. For corporations, see *Publication 542*. If your business is a Limited Liability Company (LLC), you select how the company will be taxed: either as a sole proprietorship, partnership, corporation, or S-corporation. Chapter Six of this guidebook provides information concerning the options for choosing a legal form for the business.

JUST THE BASICS

Record Keeping Issues

Before discussing the types of records to keep, let's touch on two essential features of an effective record keeping system. Your accounting information has to be *timely* and *accurate*. One of these features without the other is not sufficient. Financial statements that are accurate to the penny, but are generated too late to act on, are useless. Similarly, timely financial statements are worthless if they are inaccurate.

Record Keeping Issues

Except in a few cases, the law does not require a business to keep specific types of records. Any record keeping system that accurately reports income is acceptable. As discussed earlier, the type of business affects the kinds of records required for federal tax purposes. The law requires that a business's financial records reflect total gross income. For tax and management purposes, expenses should be recorded during the same period as the associated income was generated. Regardless of the accounting system, the record keeping system should include a summary of business transactions. This summary is ordinarily made in the accounting journals and ledgers. For most small businesses, the business checkbook is the primary source of original entry in the business's record keeping system. In addition to the checkbook, supporting documentation such as sales slips, paid bills, invoices, receipts, deposit slips, and cancelled checks must be retained.

RECORD KEEPING SYSTEMS

Single Entry System

The single entry system of record keeping is the simplest to maintain, but is neither suited nor recommended for many businesses. The single entry system is based on the profit and loss statement (income statement), simply recording the flow of income and expenses through the use of cash receipts and cash disbursement. The most common component of this system is a daily and monthly summary of cash receipts and disbursements. (Note: The examples in this section are taken from *IRS Publication 583*, pp. 18-21.)

RECORD KEEPING ISSUES

Daily Summary of Cash Receipts

Date ________________________________

Cash Sales $263.60

Sales Tax 4.20

TOTAL RECEIPTS $267.80

Cash on Hand

Cash in register (including unspent petty cash)

Coins.............................. $23.75

Bills 143.00

Checks 134.05

TOTAL CASH IN REGISTER $300.80

Add: Petty cash slips.. 17.00

TOTAL CASH $317.80

Less: Change and petty cash

Petty cash slips.......................... $17.00

Coins and bills
(unspent petty cash).................... 33.00

TOTAL CHANGE AND PETTY CASH FUND $50.00

TOTAL CASH RECEIPTS $267.80

RECORD KEEPING ISSUES

Monthly Summary of Cash Receipts

Year: 20XX Month: January

Day	Net Sales	Sales Tax	Daily Receipts	Deposit
3	263.60	4.20	267.80	
4	212.00	3.39	215.39	
5	194.40	3.10	197.50	680.69
6	222.40	3.54	225.94	
7	231.15	3.68	234.83	
8	137.50	2.13	139.63	600.40
10	187.90	2.99	190.89	
11	207.56	3.31	210.87	401.76
12	128.95	2.05	131.00	
13	231.40	3.77	235.17	
14	201.28	3.21	204.49	
15	88.01	1.40	89.41	660.07
17	210.95	3.36	214.31	
18	221.80	3.53	225.33	439.64
19	225.15	3.59	228.74	
20	221.93	3.52	225.45	
21	133.53	2.13	135.66	589.85
22	130.84	2.08	132.92	
24	216.37	3.45	219.82	352.74
25	220.05	3.50	223.55	
26	197.80	3.15	200.95	
27	272.49	4.34	276.83	701.33
28	150.64	2.40	153.04	
29	224.05	3.56	227.61	
31	133.30	2.13	135.43	516.08
TOTAL	4,865.05	77.51	4,942.56	4,942.56

Check Disbursements Journal

Year: 20XX Month: January

Day	Paid To	Check #	Amount of Check	Materials	Gross Payroll	Federal Withheld Income Tax	FICA Social Security Reserve	FICA Medicare Reserve
3	Dale Advertising	74	85.00					
4	City Treasurer	75	35.00					
4	Auto Parts, Inc.	76	203.00	203.00				
4	John E. Marks	77	214.11		260.00	(20.00)	(16.12)	(3.77)
6	Henry Brown	78	250.00					
6	Mike's Deli	79	36.00					
6	Joe's Service Sta.	80	74.50	29.50				
6	ABC Auto Paint	81	137.50	137.50				
7	Henry Brown	82	225.00					
14	Telephone Co.	83	27.00					
15	National Bank (Tax Deposit)	84	119.56			40.00	32.24	7.54
18	National Bank	85	90.09					
18	Auto Parts, Inc.	86	472.00	472.00				
18	Henry Brown	87	275.00					
18	John E. Marks	88	214.11		260.00	(20.00)	(20.00)	(16.12)
21	Electric Co.	89	175.30					
21	M.B. Ignition	90	66.70	66.70				
21	Baker's Fender Co.	91	9.80	9.80				
21	Petty Cash	92	17.00	15.00				
21	Henry Brown	93	225.00					
25	Baker's Fender Co.	94	150.00	150.00				
25	Enterprise Prop.	95	300.00					
25	State Treasurer	96	12.00					
25	State Treasurer	97	65.00					
			3,478.67	1,083.50	520.00	-0-	-0-	-0-
	Bank Service Charge		10.00					
TOTALS			3,488.67	1,083.50	520.00	-0-	-0-	-0-

Check Disbursements Journal
(Continued)

Year: 20XX Month: January

Day	State Withheld Income Tax	Employer's FICA Tax	Electric	Interest	Rent	Telephone	Truck/ Auto	Drawing	General Acounts	
3									Advertising	85.00
4									License	35.00
4										
4	(6.00)									
6								250.00		
6									Shop Holiday Party	36.00
6							45.00			
6										
7								225.00		
14						27.00				
15		39.78								
18				18.09					Loan	72.00
18										
18								275.00		
18	(6.00)									
21			175.30							
21										
21										
21									Postage	2.00
21								225.00		
25										
25					300.00					
25	12.00									
25									Sales Tax	65.00
	-0-	39.78	175.30	18.09	300.00	27.00	45.00	975.00		295.00
										10.00
TOTALS	-0-	39.78	175.30	18.09	300.00	27.00	45.00	975.00		305.00

Double Entry System

RECORD KEEPING ISSUES

The double entry record keeping system is more sophisticated and uses books (known as journals and ledgers) to record transactions. A journal records each business transaction in chronological order. Some businesses require separate journals for transactions that occur frequently. A ledger is a book that contains the totals from all journals. These totals are organized into different accounts. Business transactions are first entered in the journal and then posted to ledger accounts. These accounts show income, expenses, assets (items of value owned by business), liabilities (debts of a business), and owner's equity (assets minus liabilities) representing the owner's stake in the company.

The first step in creating a double entry record keeping system is to determine the accounts that need to be monitored. The individual accounts should be numbered and titled for easy identification and assembled into a chart of accounts. The key to an effective chart of accounts is to keep it simple: use descriptions that are short and descriptive and design your numbering system for expansion. A sample chart of accounts follows.

Record Keeping Issues

Chart of Accounts
Average Small Business, USA

Balance Sheet Accounts

1. Assets

101 Cash
102 Accounts Receivable
103 Inventory
104 Equipment
105 Accumulated Depreciation

2. Liabilities

201 Accounts Payable
202 Notes Payable
203 Sales Tax Payable
204 Loan Due To Shareholders

3. Equity

301 Common Stock
302 Paid-In Capital
303 Retained Earnings

Income Statement Accounts

4. Revenues

401 Sales
402 Interest Income
403 Miscellaneous Income

5. Expenses
Cost of Goods Sold

501 Cost of Merchandise Sold
502 Freight Expense

6. Operating Expenses

601 Wages
602 Rent
603 Advertising
604 Utilities
605 Insurance
606 Telephone
607 Payroll Tax
608 Bank Fees
609 Office Supplies
610 Depreciation

The record keeping system accurately records the flow of money in and out of the business through these major accounts. The income statement accounts (income and expenses) are closed at the end of each tax year. The balance sheet accounts (assets, liabilities, and owner's equity) remain open permanently. In a double entry system, each account has a left side for debits and a right side for credits. It is self-balancing because every transaction is recorded as a debit entry in one account and as a credit entry in another.

Under this system, the total debits must equal the total credits in both the journal entries and the ledger postings. If the debit and credit account balances are not equal, there is an error that must be found and corrected.

The following is a general journal sample. This book is the original entry for financial transactions of the business. Information in the general journal needs to be posted to the appropriate individual ledger accounts.

GENERAL JOURNAL SAMPLE

Account: Cash Account No.: 101

Date	Description	Acct. Ref.	Debit	Credit
20XX				
Jan. 15	Advertising Expense	603	$50.00	
	Cash	101		$50.00
	Brochures - Check #1234			
Jan. 15	Accounts Receivable	102	$350.00	
	Sales	401		$350.00
	Sold two desks to Smith Brothers			
	Invoice #872			
Jan. 19	Accounts Payable	201	$50.00	
	Cash	101		$50.00
	Paid Jones Company			
	Check #1236			
Jan. 20	Cash	101	$2,000.00	
	Sales	401		$2,000.00
	Design consulting fee to Mrs.			

After transactions are recorded in the general journal, they are posted to the appropriate ledger accounts. Next is a sample ledger for a company's cash account, based on the sample general journal above. Notice the consistent use of account names and numbers.

Record Keeping Issues

CASH LEDGER SAMPLE

Date	Description	Post Ref.	Debit	Credit	Balance	DR CR
20XX						
	FORWARD BALANCE				$5,475.00	DR
Jan. 15	Advertising Expense	GJ3		$50.00	$5,425.00	DR
Jan. 19	Accounts Payable	GJ3		$50.00	$5,350.00	DR
Jan. 20	Design Consulting Fee	GJ3	$2,000.00		$7,350.00	DR

Please note that the above sample is just one of the general ledger accounts. There should be a general ledger for all the accounts in your chart of accounts. For general ledger accounts that need to keep up with more detailed information, such as accounts receivable and accounts payable, subsidiary ledgers can be used. A subsidiary ledger tracks individual customer and/or vendor account activities and balances. The total of these subsidiary accounts should always equal the general ledger balance for that account. Subsidiary account records need to include the customer's/vendor's name, date of sale/purchase, invoice number, invoice amount, terms, date collected/paid, and account balance.

Ledger accounts should be monitored on a routine basis. Accounts receivable should be reviewed on a routine basis to determine the "age" of the individual accounts. The older the account, the harder it is to collect the amount due; therefore, it is important to pursue accounts that are past due. Managing accounts payable in an orderly manner so that timely payments are made ensures that the business maintains a good credit standing with vendors.

Supplemental records may be necessary to assist in proper identification of a business's balance sheet accounts or to meet IRS requirements for documentation of expenses. Examples of these include a fixed asset log, travel expense records, and payroll records.

A fixed asset log is needed to record information on the purchase and sale of the business's fixed assets such as equipment, vehicles, and buildings. The following items should be recorded in the fixed asset log:

RECORD KEEPING ISSUES

- asset description
- asset cost
- date purchased
- percentage of the asset used in the business
- asset depreciation method
- date sold with sale price (if applicable)

A travel expense log is necessary if a vehicle is used in the business and for personal transportation. The log serves as documentation for deducting the business-related portion of operating and maintaining the vehicle. Under general circumstances the IRS allows either the actual expenses or a standard mileage rate to be deducted. The records you keep depend on which method you use. If the standard mileage rate is used to determine the business's expense, a mileage log of business travel must be maintained. If actual expenses are to be deducted, a more sophisticated method is needed to record gas, insurance, maintenance, etc. For additional information on vehicle expenses, consult *IRS Publication 463*.

EMPLOYEE RECORD KEEPING

Hiring an employee generates a large amount of paperwork and record keeping activity. As stated in Chapter Six, businesses with employees need an Employee Identification Number to properly file payroll taxes. An Employee Identification Number and related forms can be found at the agencies in the following table. Both the Federal and State tax guides will provide the most current procedures and forms as these do change periodically.

Record Keeping Issues

AGENCY	FORMS/PUBLICATIONS
Internal Revenue Service Stakeholder Partnerships, Education and Communication Services 401 W. Peachtree Street, NW Suite 410 Atlanta, GA 30308 1-800-829-1040 www.irs.gov	Circular E: Employer's Tax Guide Form SS-4: Application for Employer ID Number Form W-4: Each employee must fill out to authorize tax withholding Form 940: Employer's Annual Federal Unemployment Tax Return Form 941: Employer's quarterly Federal Tax Return Form 8109: Federal Tax Deposit Coupon
Georgia Department of Revenue Income Tax Division 1800 Century Center Blvd., NE Atlanta, GA 30345-3205 (404)417-4477 (inside metro Atlanta) (800)602-8477 (outside metro Atlanta) www.dor.ga.gov	G-7: Quarterly Reconciliation Return G-4: Employee's Withholding Allowance Certificate Employer's Tax Guide
Georgia Department of Labor www.dol.state.ga/find_us.htm	DOL-1A: Application for GDOL Tax Account or Status Change DOL-4N: Tax and Wage Report Form
U.S. Citizenship and Immigration Service Atlanta District 2150 Parkland Dr. Atlanta, Ga 30345 (404)331-2762 (800)375-5283 www.uscis.gov	Form I-9: Employment Eligibility Verification Required to verify that employee is U.S. citizen or alian authorized to work in U.S.
The Georgia New Hire Reporting Program P.O. Box 38480 Atlanta, GA 30334-0480 (404)525-2985 (888)541-0469 www.ga-newhire.com	All employees are required to report new hires to the state. This information is used to identify parents who are delinquent in child support payments.

RECORD KEEPING ISSUES

The following information is required in every employee's file:

- *Form G-4*
- *Form W-4*
- *Form I-9*
- Name, address, phone #, and SS #
- The date employee was hired, rehired, or returned to work after temporary layoff
- The date and reason employee was separated from employment
- Wage rates and pay period

Important: You are also required to keep employment records that show the total wages paid and the total deductions (i.e., state and federal taxes, FICA, retirement accounts, insurance premiums) withheld from each employee during each pay period.

The following is an example of an employee compensation record from the *IRS Publication 583*.

RECORD KEEPING ISSUES

Employee Compensation Record

Name John E. Marks ☐ Full Time Soc. Sec. No. 567-00-8901

Address 1 Elm St., Anytown, NJ 07101 ☒ Part Time Date of Birth 12-21/65

Phone 555-6075 No. of Exemptions 1/single

		Hours Worked																Earnings				Deductions				
Pay Period Ending	Date Paid	S	M	T	W	T	F	S		S	M	T	W	T	F	S	Total Regular Hours	Overtime	Regular Rate	Overtime Rate	Total	Social Security	Medicare	Federal Income Tax	State Income Tax	Net Pay
1-1	1-4		5		5	5	5				5		5	4	6		40		$6.50		$260.00	$16.12	$3.77	$20.00	$6.00	$214.11
1-15	1-18		4	4	4	4	4	2			4	3	4	4	3		40		$6.50		$260.00	$16.12	$3.77	$20.00	$6.00	214.11
																	80				$520.00	$32.24	$7.54	$40.00	$12.00	$428.22
etc.																										
QUARTERLY TOTALS																					$1,262.40	$78.23	$18.31	$100.00	$30.00	$1,035.86

If an individual performing work is an independent contractor, then the business is not responsible for payroll taxes and the independent contractor should complete a *W9 form*. If the independent contractor is paid more than $600 in a year, a *Form 1099-Miscellaneous Income* must be completed and submitted to the IRS and the contractor. Independent contractors are responsible for their own payroll taxes.

Many small business owners make an expensive mistake by treating employees as independent contractors. The IRS has guidelines for establishing whether or not an individual is an independent contractor or an employee. The guidelines are discussed in Chapter Six of this guidebook. Additionally, more details are available in IRS publication 15A, Employer's Supplemental Tax Guide. If an individual is treated as an independent contractor and the IRS determines the worker was an employee, the business may be liable for the uncollected payroll taxes plus penalties and interest.

TAXES

Income Tax

The legal structure of the business will determine the way the business or the business owner will pay federal and state income taxes on the earnings of that company. It will also determine the method and the timing of estimated tax payments.

If the business is a sole proprietorship, the revenue and expenses from business activity are reported on an *IRS Schedule C* and included with your *Form 1040* individual tax return. The net income from the business (revenues minus expenses) will be taxed at the owner's individual tax rate.

If the business is a partnership, the partnership is required to file a tax return on *IRS Form 1065*. However, partnerships are not taxable entities and the earnings of the company "flow through" on *IRS Form K-1* to be reported on the partners' individual returns. Just like the sole proprietorship, partners are taxed at their individual tax rates.

If the business is a corporation, it will need to file a corporate return. If it is a C-Corporation, it will use *IRS Form 1120* and is responsible for paying its own taxes. If it is an S-Corporation, it must file *IRS Form 1120S* and, just like a partnership, the earnings of the corporation are reported on the shareholders' individual returns and taxed at the shareholders' individual rates.

If the business is a Limited Liability Company (LLC), you must select to be taxed as one of the above entities. Schedule C and *Forms 1120*, *1120S* and *K-1* can be found on the IRS web site at www.irs.gov.

RECORD KEEPING ISSUES

Sales Tax

Businesses operating in Georgia that sell or rent tangible items to the final consumer (as opposed to wholesalers) must comply with Georgia Department of Revenue regulations, which include collecting and remitting sales and use tax. The sales and use tax rate in Georgia is four percent (4%). In addition, most counties have exercised their local option to add on taxes for specific projects. These tax-specific additions are known as Special Purpose Local Option Sales Tax (SPLOST). A sales tax number is required for each business before opening. The sales tax number, as well as instructions for collecting, reporting, and remitting the money to the state on a monthly basis, can be obtained from:

The Georgia Department of Revenue
Sales and Use Tax Division
P.O. Box 105408
Atlanta, GA 30348-5408
1-877-423-6711
https://dor.georgia.gov/

Employment Tax

Businesses with employees are required to withhold state and federal income taxes from each employee's paycheck. In addition, the company has to withhold and match the employee's Social Security (6.2% of gross pay) and Medicare (1.45% of gross pay) payments. The employer matches those amounts, a total of 7.65 percent of the employee's gross pay. There is an annual maximum amount of social security taxes, but no limit on Medicare taxes. See IRS Circular E for more information.

The employer deposits the Social Security tax, Medicare tax, and the employer's matching payment, plus the amount of federal income tax withheld from the employee in an authorized financial institution (most banks). The timing of the deposits depends on the amount of the company's total payroll. Medicare and Social Security taxes (IRS Form 941) require a quarterly return which lists the deposits made in that quarter and calculates if any additional amount is due.

Employers can also deposit payments online using the free Electronic Federal Tax Payment System, or EFTPS. For more information, visit https://www.eftps.gov/eftps.

Employers are also responsible for paying federal and state unemployment taxes. These amounts are not withheld from employees. The federal unemployment tax (FUTA) is reported on *IRS Form 940* Employers Annual Federal Unemployment Tax return. The Georgia

Department of Labor handles the state unemployment tax (SUTA). The tax rate changes based on a variety of factors; however, new or newly covered employers are assigned a total tax rate of 2.7 percent until such time as they are eligible for a rate calculation based on their experience rating history. For detailed information, contact the Georgia Department of Labor via their web site http://www.dol.state.ga.us/em/.

New businesses should estimate the total employer tax cost at 10.95 percent of gross payroll. This percentage includes the 6.2 percent Social Security, the 1.45 percent Medicare, the 2.7 percent SUTA, and the 0.6 percent FUTA. The FUTA tax rate had been .8 percent, but the 2 percent surcharge expired, making the rate .6 percent in 2012. Always check the irs.gov and gador web sites for up-to-date rates.

At the end of the tax year, all employee wages and withholdings must be reported on *IRS Form W-2*. If the business used independent contractors and they were paid in excess of $600 per year, their annual earnings must be reported on *IRS Form 1099*.

Substantial interest and penalties will apply if a business fails to pay its employee tax obligations when and in the amount due.

Self Employment Tax

Sole proprietorships that report a profit on the *IRS Schedule C* are required to pay self-employment tax on that profit. The amount of self-employment tax is 15.3 percent of the profits of the business (the same as the total of the employer and employee's Social Security and Medicare contributions). Sole proprietors are not subject to *IRS Form 941* withholdings, but they may be required to make deposits of estimated federal and state taxes based on the profits of the business.

Property Tax

Businesses operating in Georgia are subject to an ad valorem property tax on the real property, equipment, and inventory owned by the business as of January 1st of each year. Local county or city officials determine the value of property and they establish the millage rate used to determine the tax due. The tax a business pays will vary widely across municipalities and counties. Property taxes are a significant consideration for businesses with large investments in inventory, property, or equipment. Contact your county and/or city tax commissioner for details.

Additional Considerations

SUPPORTING DOCUMENTS

A record keeping system should include a summary of transactions. The books should accurately report gross income and expenses. Appropriate supporting documents must be maintained to verify the transactions summarized. Supporting documents include sales slips, paid bills, invoices, receipts, deposit slips, and cancelled checks.

HOW LONG SHOULD YOU KEEP RECORDS?

According to the IRS, you must keep your records for as long as they may be needed for the administration of any provision of the Internal Revenue Code. Generally, this means you must keep records that support an item of income or deduction on a return until the period of limitations for that return runs out. For information on the period of limitations, refer to *IRS Publication 583*.

If a return is not filed or the return is found to be fraudulent, there is no period of limitations. Remember that even though records may no longer be needed for tax purposes, they may be needed for non-tax purposes, such as for your insurance company or creditors.

DO YOU NEED AN ACCOUNTANT?

Even though some small business owners are experienced and knowledgeable about accounting and tax issues, oftentimes it is important to seek the assistance of an outside expert. When trying to decide on an accountant, the business owner should consider the accountant's technical expertise, communication skills, and ability to respond in a timely manner. In the start-up phase of a business, an accountant can be instrumental in setting up the books, including creating a chart of accounts and a standard operating procedure for handling accounting needs. Many business owners need an accountant's assistance to monitor the business on a monthly basis until the owner is able to manage the records properly. It is especially important to have an accountant assist with determining tax obligations. One way to find a suitable accountant is to seek referrals from a banker, an attorney, and other small business owners. To maximize the benefits of having an accountant, a business owner should communicate regularly and provide information in a timely manner. Seek tax strategies and advice throughout the year instead of waiting until year-end.

ADDITIONAL CONSIDERATIONS

AUTOMATING YOUR RECORD KEEPING SYSTEM

Business owners can choose among several affordable accounting software packages. These programs help manage records and can provide quick access to financial information through multiple reports. To find an appropriate match, determine what type of information is needed for the business and then match these needs to the software and hardware capabilities. Picking a computer accounting program might require the assistance of an accountant. Many accountants prefer to work with certain programs. It would be prudent to make sure that the accountant has proficiency with the type of software being considered. Also, the business owner needs to understand the accounting system.

By keeping comprehensive and accurate records, a business owner can determine whether or not financial (and other) goals are being met. Monitoring progress is the first step in growing the business into a viable, competitive organization. Other activities necessary to build a business are discussed in the next chapter.

CHAPTER EIGHT: NEW BUSINESS SUCCESS

The doors are open. You have started your new business. The American Dream is yours. But are you ready to *stay* in business? Starting a business can often seem easy in comparison to the challenges you will face of remaining in business. According to the latest statistics from the U.S. Small Business Administration, 7 out of 10 new employer firms survive at least two years, and one-half survive at least five years.[6] An important key to succeeding in business is to work *on* your business while continuing to work *in* your business.

Maintenance is vital to any new business. Most things worth keeping need some sort of maintenance. For example, a house needs to be painted and cleaned and have the lawn trimmed. Our bodies need exercise, nourishment, and plenty of rest. And cars need to have fuel, oil changes, and tune-ups. Similarly, your business cannot continually operate under the premise "if you build it, they will come." Furthermore, a sturdy foundation will enable your business (home, body, or car) to better withstand potential setbacks due to age or external factors, such as a slumping economy, a new competitor, or shifting demographics. Systematically working *on* your business and keeping it healthy will provide a much greater likelihood for your business to weather these challenges satisfactorily.

While the focus of this guidebook is starting a new business, these management issues also need your consideration, future study, and application.

Marketing and Public Relations

Marketing is an integrated process with many optional components. Some components prove more effective for specific business types, specific markets, or at specific times. Remember that marketing is an on-going activity. The market is never static. Therefore, the marketing of your business should never cease.

Another important consideration is the message you want to convey to your potential customers. Brevity, clarity, and consistency produce an effective message that can build a valuable brand image. Phillip Kotler of Northwestern University defined the core elements of marketing as *product, price, place, and promotion*. There have been many variations on this theme over the years; however, this basic structure remains widely accepted. Additionally, new strategies in marketing continue to emerge, such as social media marketing and marketing to customers through now widely used mobile devices. Keeping apprised of these new methods and applying them when applicable will promote growth and vitality in your business venture. The marketing objectives specified in your marketing feasibility study should be incorporated into a marketing plan.

[6] SBA Office of Advocacy. *Frequently Asked Questions 2014:* https://www.sba.gov/sites/default/files/advocacy/FAQ_March_2014_0.pdf.

Marketing and Public Relations

Public relations accompanies and assists marketing as it refers to communications with all public entities, whether to induce sales, simply transfer information, or reinforce an image or ideal important to your business. Like advertising and other internally directed promotional activities, public relations activities can influence the perception of your business, its products or services, or employees. However, the audience for public relations activities is broader than the customer base. It includes groups such as the media, legislative and regulatory organizations, and community groups, whose interest in your business may go well beyond whether or not they purchase whatever you are selling. While public relations activities may not be a top priority for a new business, it is important to begin thinking along these lines. During a time of repair or re-direction, previous public relations activities and crisis-mode activities can determine whether or not your business clears the hurdle of success.

Computer Systems and the Internet

Your system needs should align with those of your business. Different types of businesses will need specialized equipment and programs. At a minimum, almost every business should conduct all record keeping via computer either through a simple spreadsheet or through reputable accounting software.

The question today is not whether or not to use the Internet, but how to use it for your business. The type of business, the market, and the specific goals of your business affect the extent to which you should use the Internet, including social media such as Facebook, Twitter, LinkedIn, etc. Marketing through mobile devices should also be considered. Mobile users of social media increased by 62 percent in 2011.[7] Small businesses should at least have a basic web site as an informational tool for customers and coordinate it with other marketing efforts. Other principal uses of the Internet include email, purchasing products/services, conducting research, sharing data, intranets, and employee recruitment. If you are considering utilizing the Internet as an additional distribution medium, you should bear in mind the experience of a prominent Augusta entrepreneur who stated that this endeavor is equivalent to the opening of another business.

[7] Kevin Shively, The State of Social Marketing - 2015, Simply Measured, Inc.

Customer Service

The customer is always right. This adage still applies. Numerous studies tout the fact that consumers share a negative experience four to five times more than a positive experience. Therefore, it will always be in the best interest of the business to treat customers fairly and honestly. The ideals of customer service have spread to *customer trust* and *customer loyalty*. But the bottom line of all these philosophies is basically the same: simply follow the Golden Rule, which says (in business) that we should treat each customer as we would like to be treated. Experience has taught many businesses that decision making at the level of impact (i.e., by well-trained customer service representatives) is the most efficient means of servicing the customer.

Cash Flow Management

Cash is the lifeblood of a business and, as such, a healthy cash flow is vital to the success of any business. Cash flow management goes beyond balance sheet interpretation, requiring a deeper understanding of finance. For instance, a lack of working capital might cause a business owner to seek a line of credit; however, further analysis of the situation might reveal excessively late receivables. Through more stringent collection procedures, a more comfortable cash flow can be achieved. Another scenario might show that cash flow is suffering due to profit margins that are lower than industry standards. By raising prices, such a firm could restore a healthy cash flow. High growth situations can place firms in a vulnerable state as they wrestle with investment options. The ultimate objective is to allocate cash in whatever way that will improve the business's stability.[8]

Personnel Management

Another potential dimension of business ownership is personnel management. Increasing the number of employees enables the business to grow in a more efficient manner, as more skill sets are added. In service-sector businesses, personnel management issues are especially critical, as these human resources are the most important assets. There are numerous laws regarding personnel management to ensure the fair and ethical treatment of individuals. There are also government regulations regarding payroll taxes that must be adhered to.

Strategic Planning

As stated in the introduction to this chapter, all business owners need to take some time off from working in their business in order to work on their business. A strategic planning session offers the opportunity to reflect, evaluate, and determine whether or not this business is headed in the direction desired by the business owners. An elaborate retreat with outside facilitators is not necessary for an effective strategic planning session. It may take simply an afternoon

[8]10 Tips for Better Managing Cash Flow: http://quickbooks.intuit.com/r/financial-management/10-tips-managing-cash-flow. How to Better Manage Your Cash Flow: http://www.entrepreneur.com/article/66008. Cash Flow Management: Techniques & tools: http://www.businessnewsdaily.com/4635-cash-flow-management.html

Strategic Planning

with no interruptions to review progress reports, or possibly some time out of the office with a few trusted advisors. Ultimately, the strategic planning process should fit within the "corporate culture" so that it is not obtrusive and results in a blueprint for future actions.

Conclusion

This guidebook is designed to cover the basic issues of starting a business. There are numerous other sources of information that you may find helpful. In the final chapter is a listing of books, articles, and web sites that can be valuable references. Additionally, the Georgia Small Business Development Center has numerous offices located across the state that provide consulting, continuing education, and research to Georgia entrepreneurs. Sponsored by the U.S. Small Business Administration, The University of Georgia, and other state universities and colleges, our faculty-level consultants offer a wide range of expertise with various business backgrounds. The aim of our organization is to improve the economic well-being of Georgians through the extensive support of entrepreneurship. A listing of our offices can be found on the back cover of this guidebook. To learn more about the UGA SBDC and how we can help you and your business, log onto our web site at www.georgiasbdc.org.

In the first chapter of this guidebook it was mentioned that sometimes all it takes is a little bit of luck to instigate success. Another truism states that luck usually finds those who are most prepared. Therefore, if the UGA SBDC can be of further assistance with your entrepreneurial endeavors, please let us know. Your success is our success!

CHAPTER NINE: RESOURCES

Print Resources

START-UP BOOKS

Title:	Starting and Operating a Business in Georgia
Author:	Jenkins, Michael D.
	Kindle Book on Amazon.com
Title:	Start Small, Finish Big: Fifteen Key Lessons to Start--and Run--Your Own Successful Business
Author:	Deluca, Fred | Hayes, John Phillip
	Mandevilla Press, December, 2012
Title:	The Successful Business Plan: Secrets and Strategies
Author:	Abrams, Rhonda M.
	Planning Shop, June, 2014
Title:	Summary: Low Risk, High Reward: Starting and Growing Your Business with Minimal Risk
Author:	Reiss, Bob | Cruikshank, Jeffery L.
	Business News Publishing, September, 2014
Title:	High Tech Start-Up: The Complete Handbook for Creating Successful New High Tech Companies
Author:	Nesheim, John L.
	Free Press, March 2000
Title:	J.K. Lesser's Small Business Taxes 2016: Your Complete Guide to a Better Bottom Line
Author:	Weltman, Barbara
	J. Wiley and Sons, 2016
Title:	Steps to Small Business Start-Up: Everything You Need to Know to Turn Your Idea Into a Successful Business (Small Business Strategies Series)
Author:	Pinson, Linda
	Out of Your Mind...And INto the Mark, May, 2014
Title:	New Business Ventures and the Entrepreneur
Author:	Stevenson, Howard H. [et.al]
Publisher:	Irwin McGraw-Hill, 2006
Title:	SmartStart-How to Start a Business in Georgia
Author/ Publisher:	Entrepreneur Press, 2007

REFERENCE BOOKS

PRINT RESOURCES

Title: North American Industry Classification System
Author/
Publisher: U.S. Office of Management and Budget

Title: Statistical Abstract of the United States 2012-2013: The National Data Book
Author: U.S. Department of Commerce
Publisher: Skyhorse Publishing, July, 2012

Title: Financial Studies of the Small Business, 29th Edition
Author/
Publisher:: Financial Research Associates, December 2006

Title: Directories in Print: A Descriptive Guide to Print and Non-Print Directories, Buyer's Guides, Buyer's Guides, Roster and Other Address Lists of All Kinds
Publisher: Gale Research, March, 2016

Title: Manufacturing and Distribution USA
Publisher: Gale Research, November, 2014

Title: Industry Norms and Key Business Ratios 2014
Publisher: Dun & Bradstreet Information

Title: Encyclopedia of Associations: National Organizations of the U.S,
Publisher: Gale Research, March, 2016

Title: Small Business Sourcebook: The Entrepreneur's Resource
Publisher: Gale Research, February, 2016

Title: Market Share Reporter: An Annual Compilation of Reported Market Share Data on Companies, Products, and Services
Publisher: Gale Research, September, 2015

Title: The 2015 Georgia County Guide
Publisher: Cooperative Extenstion Service and Carl Vinson Institute of Government, The University of Georgia

APPENDICES

**Sample Telephone Survey for a
New Industrial Service**

Hello. May I speak to [CONTACT NAME].

Hi. This is [INTERVIEWER] calling from [Research Company]. We are conducting a short study of procurement specialists and we'd like to ask you a few questions today about your facility. Do you have a few minutes right now to answer some questions?

[THE QUESTIONS SHOULD TAKE ONLY ABOUT 5 MINUTES – WE WANT TO LEARN ABOUT YOUR NEEDS IN TERMS OF IMPROVING OPERATION AND INCREASING EFFICIENCY THROUGH NEW SOFTWARE.]

1. Yes [CONTINUE]
2. No [WHEN WOULD BE A BETTER TIME THAT YOU MIGHT HAVE ABOUT 5 MINUTES?]

Before we start, I want to let you know that all information you provide will be kept strictly confidential. The study is completely voluntary and your name or the name of your business won't be linked individually to any information you provide. My Supervisor may also listen to part of the interview for quality control purposes.

Q1 – First, of the following software vendors, which one would you rank as having the largest perceived market share currently in the market?

[INTERVIEWER: READ RESPONSES]

1. Competitor 1 [SKIP TO Q2]
2. Competitor 2 [SKIP TO Q2]
3. Competitor 3 [SKIP TO Q2]
4. Competitor 4 [SKIP TO Q2]
5. Competitor 5 [SKIP TO Q2]
6. Other [Specify] [SKIP TO Q2]
7. Do not use a computerized system
9. Don't Know/No Answer [SKIP TO Q2]

Q1.1 – Why don't you use a computerized system?

1. [ENTER RESPONSE] ____
9. Don't Know/No Answer

Q1.2 – Do you anticipate using a computerized system in the future?

1. Yes [Why? ENTER RESPONSE]____
2. No [Why? ENTER RESPONSE]____
9. Don't Know/No Answer

[SKIP TO Q13]

Q2 – Which one of these vendors would you rank as having the largest number of customers served?

1. Competitor 1
2. Competitor 2
3. Competitor 3
4. Competitor 4
5. Competitor 5

9 – Don't Know/No Answer

Q3 – Of the software products you have personal experience with, which of these vendors would you rank as being the most favorable based on product reliability?

1. Competitor 1
2. Competitor 2
3. Competitor 3
4. Competitor 4
5. Competitor 5

9 – Don't Know/No Answer

Q4 – Of these same vendors' customer support services, which one would you rank as most favorable?

1. Competitor 1
2. Competitor 2
3. Competitor 3
4. Competitor 4
5. Competitor 5

9 – Don't Know/No Answer

Q5 – Of the following statements, which is your strongest positive impression of the software you currently use?

1. It's easy to use
2. It does everything automatically
3. It makes operations less complicated
4. I can get more work accomplished
5. Operations have become more efficient
6. Other [OFFERED BY RESPONDENT] ____

9 – Don't Know/No Answer

Q6 – Of the following statements, which one comes closest to your strongest negative impression of the software you have used?

1. It takes a computer science degree to operate
2. Continually creating work-arounds because it doesn't fit our business
3. Life was easier with paper forms
4. I spend all of my time at the computer
5. I'm suffering from information overload
6. Who knows if it has improved anything
7. Other [OFFERED BY RESPONDENT] ____

9 – Don't Know/No Answer

Q7 – If you could change one thing about your software, would you…….

[READ RESPONSES]

1. Increase automation
2. Decrease automation
3. Add functionality [HOW WOULD YOU ADD FUNCTIONALITY?] ________________________
   ____
4. Reduce functionality [HOW WOULD YOU REDUCE FUNCTIONALITY?] ________________
   ____
5. Toss the whole program out and go back to paper
6. Other [OFFERED BY RESPONDENT] ____

9. Don't Know/No Answer

Q8 – Which of the following aspects of software would you rank as most useful?

[READ RESPONSES]

1. Ease of use or being at least as easy as writing on paper forms
2. Being 'real time'
3. Reducing keyboard time, such as data entry or performing a task
4. Handheld technology, or a less paper office
5. Easier and customized reporting

9. Don't Know/No Answer

Q9 – If you created your ideal system would you …….

1. Convert to a new system
2. Modify your existing system
3. Create more work-arounds with the existing system to get the desired effect
4. Just continue with the present system if it couldn't be modified
5. Start your own company because everything else has been tried before
6. Other [OFFERED BY RESPONDENT] ____

9. Don't Know/No Answer

Q10 – Does the existing Customer Service for your software provide excellent support, good support, adequate support, poor support, or no support?

1. Excellent
2. Good
3. Adequate
4. Poor
5. No Support

9. Don't Know/No Answer

Q11 – To what do you attribute the level of service you receive? Would you say the size of your vendor, the resources of your vendor, your vendor's expertise, your vendor's commitment, or the size of your company relative to your vendor's other customers?

1. Vendor's size
2. Vendor's resources
3. Vendor's expertise
4. Vendor's commitment
5. Size of company relative to vendor's other customers
6. Other [OFFERED BY RESPONDENT] ____
9. Don't Know/No Answer

Q12 – Which of the following do you use to find out information about new software products?

12.1 – Do you use word of mouth knowledge?

1. Yes
2. No
9. Don't Know/No Answer

12.2 – Do you get information from trade magazine advertisements?

1. Yes [SPECIFY MAG NAMES] ____
2. No
9. Don't Know/No Answer

12.3 – Do you get information from Trade Shows?

1. [SPECIFY TRADE SHOW NAME(S)] ____
2. No
9. Don't Know/No Answer

Q12.4 – Do you get information from Sales Representatives?

1. Yes [WHICH COMPANIES ARE THOSE REPS FROM] ______________________________
2. No
9. Don't Know/No Answer

Q12.5 – Is there any other source where you get software product information?

1. Yes [WHAT SOURCE IS THAT] ____
2. No
9. Don't Know/ No Answer

Q13 – How much would your facility be willing to pay for a new system?

_________________ dollars [RANGE 0 - $999,995]

999,995 – 999,995 or more
999,996 – Not applicable
999,999 – Don't Know/No Answer

Q13.1 – What is your department's dollar limit or threshold for making purchases without going through formal, competitive quotations or a formal bidding process?

_________________ dollars [RANGE 0 - $999,995]

999,995 – 999,995 or more
999,996 – Not applicable
999,999 – Don't Know/No Answer

Q14 – Would you be interested in leasing application-based software via the world wide web?

1. Yes
2. No
9. Don't Know/No Answer

Q15 – Would you be interested in utilizing wireless, handheld technology to record work in the field?

1. Yes [or already use it]
2. No
9. Don't Know/No Answer

Q16 – Does your department have a separate planning department that makes the purchasing decisions for your facility?

1. Yes
2. No [SKIP Q17]
9. Don't Know/No Answer

Q17 – Do you have any other comments you feel may influence a vendor to improve software products or services? [IF YES, ENTER COMMENTS]

____
____
____

Q18 - That's all the questions I have and I appreciate your help today. Would it be possible for someone to call back at a later date if we have other questions?

1. Yes, can call back
2. No, don't call back [END INTERVIEW]

Q19 – Can I have your name [FIRST AND LAST] and phone number so we can ask for you specifically?

1. Yes [ENTER NAME] ____
   [ENTER PHONE NUMBER]__________________________________
2. No

Thanks for your help today.
Your responses will help us better understand the needs of Facilities.
Goodbye.

Sample Mail Feasiblity Questionnaire
Tennis and Fitness Complex

Hello, my name is _____ and I am with _____, a local polling firm. We are conducting a study on tennis participation in the Atlanta area. May I speak with an adult in the household?

Yes ==> (Once connected reintroduce self and purpose of study.)
No ==> When would be a good time to call him/her back?

Date: __________
Time: __________

Q1. How often do you or a member of your household play tennis?
_____ Never
_____ Once a month or less
_____ 2-3 times per month
_____ Once a week or more

Q2. Are you currently a member of a ... Which one?
_____ Tennis Subdivision? ________________________________
_____ Tennis Club? ________________________________
_____ Country Club? ________________________________
_____ Fitness Center/complex? ________________________________
_____ None/Not Applicable (Go to Q.10)

Q3. What do you like best about the tennis (Subdivision/Club/Center) of which you are a member?
____
____
____

Q4. What do you like least about the tennis (Subdivision/Club/Center) of which you are a member?
____
____
____

Q5. If you could change one thing about the tennis (Subdivision/Club/Center) of which you are a member, what would that be?
____
____
____

Q6. What are the monthly membership dues for the tennis (Subdivision/Club/Center) that you belong to?

_____ Less than $100
_____ $100 - $129
_____ $130 - $149
_____ $150 - $179
_____ $180 - $200
_____ More than $200

Q7. And was there any sort of initiation or membership fee to join?
_____ Yes ==> Please describe: ____

_____ No

Q8. Are these dues part of a package deal, for example a family plan or a limited time special?
_____ Yes ==> Please describe: ____

_____ No

Q9. Now I am going to read to you a short list of features, and I would like for you to tell me whether or not these are offered at your Tennis (Subdivision/Club/Center). (Check affirmative responses only)

_____ Nautilus Equipment
_____ Sports apparel and equipment shop
_____ Classes/ Lessons/ Instructions
_____ Indoor tennis courts
_____ Club house or reception area available for rent
_____ Aerobics studio
_____ Availability of refreshments
_____ Personal lessons
_____ Planned social events

Q10. I would like for you to rate how important each of the following features is to you. We will be using a scale of 1 to 5 with 1 representing "It is ***not important at all*** that my tennis (subdivision/club/center) offer this feature" and 5 representing "It is ***very important*** that my tennis (subdivision/club/center) offer this feature." And remember you can use any number between 1 and 5.

_____ Nautilus Equipment
_____ Aerobics studio
_____ Sports apparel and equipment shop
_____ Availability of refreshments
_____ Group tennis lessons (once a week for one person)
_____ Personal tennis lessons (at an additional charge)
_____ Planned social events
_____ Club house or reception area available for rent

_____ Indoor tennis courts
_____ Clay courts
_____ Hard courts
_____ Stadium court
_____ Located within a 20 minute drive from home
_____ Located within a 20 minute drive from the office

Q11(a). If a new tennis facility were to open on the north side of Atlanta offering all the amenities we discussed, would you be willing to pay a one-time ***family*** membership fee of ***$4,000*** plus _____ per month to be a member?
_____ $200 (Go to Q12)
_____ $150 (Go to Q12)

Q11(b). If a new tennis facility were to open on the north side of Atlanta offering all the amenities we discussed, would you be willing to pay a one-time ***family*** membership fee of ***$3,000*** plus _____ per month to be a member?
_____ $200 (Go to Q12)
_____ $150 (Go to Q12)

Q11(c). If a new tennis facility were to open on the north side of Atlanta offering all the amenities we discussed, would you be willing to pay a one-time ***individual*** membership fee of ***$2,500*** plus _____ per month to be a member?
_____ $150 (Go to Q12)
_____ $200 (Go to Q12)
_____ Not willing to change membership
_____ Not interested in any membership

Q12. Why is this? ____
____
____
____

The following questions are for classification purposes only and will not be traced back to the individual.

D1. Please stop me when I read the category that best describes your age:
_____ 18 - 24 _____ 25 - 34
_____ 35 - 44 _____ 45 - 56
_____ 55 - 64 _____ 65+

D2. What is your residential zip code: __________
What is your office zip code: __________

D3. How many adults are in your household? _____
How many children are in your household? _____

D4. Please stop me when I read the category that best describes your annual household income.

_____	$19,999 or less	_____	$20,000 to $29,999
_____	$30,000 to 49,999	_____	$$50,000 to $74,999
_____	$75,000 to $99,999	_____	$100,000 to $149,999
_____	$150,000 or more	_____	Refused

Thank you for your help evaluating current and proposed tennis centers in Atlanta.

Sample Intercept Interview
Coffee Shop Feasibility Survey

We are taking a quick consumer poll and were hoping that you could participate. This survey shouldn't take more than ten minutes.

1. How often do you drink coffee or coffee related beverages?

____ More than once per day   ____ Once a week
____ Once per day   ____ A few times per month -> *
____ Several times per week   ____ Less than once per month -> *
*Thanks and have a good day

2. Now, I=d like to know a little bit more about when, where, and how much coffee you drink. Do you drink coffee in the Morning? Afternoon? Evening? Night?

1= Almost Always   2=Sometimes   3=Never*
(*Do not ask the following questions)

(Repeat the following questions for each time of day and record answers in the table.)

About how many cups do you drink then?

Where do you drink your coffee? (home/ car/ office/ restaurant/ other)

And where would that coffee have been purchased or made? (grocery store/ convenience store/fast food restaurant/coffee shop/restaurant-other)

And finally, why do you usually purchase coffee at that time and place? (convenient location/ premium taste/modest price/variety of coffee drinks/availability of complimentary food items/store atmosphere/other-list)

	1,2,3	# of cups?	Where consumed?	Where purchased-/made?	Reason(s) for purchase?
Morning					
Afternoon					
Evening					
Night					

3. Do you drink coffee beverages

	Yes	No
Only with your meals?	____	____
As a beverage alone?	____	____
Or as a "treat"?	____	____

4. Do you drink coffee beverages more often during certain times of the year than other times? If so, when? ____
____
____

5. When you purchase coffee or coffee related beverages, how much do you usually spend per cup of coffee?
____ Less than one dollar
____ One to two dollars
____ Two to five dollars
____ More than five dollars

6. When you purchase coffee or coffee related beverages, do you tend to purchase other food items as well? If so, what items and how much money do you spend on them?__________
____
____
____

That's all the questions I have. Thanks for your time and your help!

NOTES

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