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ABSTRACT

This three-part curriculum for entrepreneurship education is primarily for postsecondary level, including four-year colleges and adult education, but it can be adapted for special groups or vocational teacher education. The emphasis of the seven instructional units in Part II is establishing a business. Unit F focuses on financing the business. It introduces some basic financial concepts and statements and provides help in locating and distributing one's financial resources. Material is organized into three levels of learning which progress from simple to complex concepts: Exposure, Exploration, and Preparation/Adaptation. Each level contains preassessment; teaching/learning objectives; substantive information (questions in margins guide the students' reading); activities, including a postassessment; and a self-evaluation. Definitions of important terms are found at the beginning of the unit; a bibliography and listing of sources for further information are appended. The four-page instructor's guide contains the teaching/learning objectives, teaching/learning delivery suggestions, and pre/postassessment suggested responses. (YLB)

Research and Development Series No. 194 B-6

PACE

A PROGRAM FOR ACQUIRING COMPETENCE IN ENTREPRENEURSHIP

PART II: Becoming an Entrepreneur
UNIT F: How to Finance the Business

The National Center for Research in Vocational Education
The Ohio State University
Columbus, Ohio 43210

1980

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PART II: BECOMING AN ENTREPRENEUR

UNIT F: HOW TO FINANCE THE BUSINESS

TABLE OF CONTENTS

FOREWORD

Traditionally vocational education has been geared primarily to preparing students for employment--to preparing employees. Yet there is another career path available; students can learn how to set up and manage their own businesses. They can become entrepreneurs.

Vocational education, by its very nature, is well suited to developing entrepreneurs. It is important that entrepreneurship education be developed and incorporated as a distinct but integral part of all vocational education program areas. A Program for Acquiring Competence in Entrepreneurship (PACE) represents a way to initiate further action in this direction.

The strength behind these instructional units is the interest and involvement of vocational educators and successful entrepreneurs in the state of Ohio and across the nation. Special recognition is extended to the project staff: Lorraine T. Furtado, Project Director and Lee Kopp, Program Associate. Appreciation is also expressed to the many who reviewed and revised the drafts of the units: Ferman Moody, Hannah Eisner, and Sandra Gurvis. We owe a special thanks to those consultants who contributed to the content of this publication: Carol Lee Bodeen, Louis G. Gross, Douglass Guikema, Peter G. Haines, Philip S. Manthey, Charles S. McDowell, Mary E. McKnight, Steven R. Miller, Barbara S. Riley, Barbara A. Rupp, Ruth Ann Snyder, Robert L. Suttle, Florence M. Wellman and Roy H. Young.

Robert E. Taylor
Executive Director
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Research in Vocational Education

HOW TO USE PACE

A Program for Acquiring Competence in Entrepreneurship (PACE) is a curriculum responsive to the need for instruction in entrepreneurship. It is primarily for postsecondary level, including four year colleges and adult education, but it can also be adapted for special groups. PACE is divided into three parts (1) Getting Ready to Become an Entrepreneur, (2) Becoming an Entrepreneur (establishing a business), and (3) Being an Entrepreneur (operating a business).

Each of the three parts has a set of instructional units which relate to that topic. Within these units, the material is organized into three levels of learning: Exposure, Exploration, and Preparation/Adaptation. These levels of learning progress from simple to complex concepts.

The levels of learning will enable you to use the PACE materials to suit your individual needs. You may find it best to work with the exposure level of one unit and the exploration level of another. Or, you may choose to pursue one level throughout the entire series. You might also want to work through two or more levels in one unit before going on to the next unit.

Before beginning a unit, discuss with your instructor what level or levels of learning in that unit are most appropriate to your goals and abilities. Read the unit overview and look through the pre/post-assessments for the three levels to help you in your choice. Also check the list of definitions you might need to look up or research for that level.

When you are ready to start, turn to the level you have chosen, take the preassessment and identify those items which you feel need special attention in the unit. [illegible] look at the learning objectives; they will tell you what you should be able to do by the time you finish that level of learning.

As you read, you will notice questions in the margin alongside the substantive content portion of each level. Use these questions to guide your [illegible]

At the end of each level of learning are activities which help you become involved with the content presented in the unit. You and your instructor can decide on how many activities you should do; you may want to do several or you many need to do all.

Then, evaluate yourself. Is there any material that you need to review before you take the postassessment? The difference in your answers on the pre/postassessments should show you how much you have grown in your knowledge of entrepreneurship.

When you and your instructor feel that you have successfully completed that level, you are ready to begin another level of learning, either in the same unit or in another.

OVERVIEW OF THE UNIT

Determining the amount of money you will need to start up your business is not a simple task. At the outset you will have to raise enough capital to cover initial inventory and all start-up expenses. You must also be able to cover operating and personal expenses until the business begins to break even. Once you decide how much money you will need, you must ask the question, "Where can I get the money to finance the business?" An understanding of some basic financial concepts and statements will help you determine and gather the finances necessary for a successful business venture. This unit introduces these financial concepts and statements and will help you locate and distribute your financial resources.

DEFINITIONS TO KNOW BEFORE YOU BEGIN

As you read through a level, you might find some unfamiliar words. Listed below are several business terms used in each level. Knowing these before you begin might help you to better understand that level.

EXPOSURE

amortize	cash flow

EXPLORATION

short-term loan	trade credit
intermediate-term loan	gross profit
long-term loan	gross margins
	net profits

PREPARATION/ADAPTATION

start-up costs	net profits
operation expenses	gross profits
projected sales income	sales volume
	trade credit

PACE

PATH OF STUDY

PART I-- GETTING READY TO BECOME AN ENTREPRENEUR

Unit I A

Unit I B

Unit I C

PART II-- BECOMING AN ENTREPRENEUR

Unit II A

Unit II B

Unit II C

Unit II D

Unit II E

YOU ARE HERE Unit II F-- How to Finance the Business

Unit II G

PART III -- BEING AN ENTREPRENEUR

Unit III A

Unit III B

Unit III C

Unit III D

Unit III E

Unit III F

Unit III G

Unit III H

EXPOSURE

PREASSESSMENT

Here are some questions that test for knowledge of the contents of this level. If you are very familiar with the information needed to answer them, perhaps you should go to another level or unit - check with your instructor. Otherwise, jot down your answers. After you've read through this level, take the postassessment at the end of the "Exposure Activities" section and measure what you've learned.

1. What are start-up costs?
2. Estimate your net worth.
3. Who would you consult to get the information you need on preparation of financial statements?
4. What is the difference between equity financing and debt financing?
5. What is a business plan and what do you think it should include?

TEACHING/LEARNING OBJECTIVES

Upon completion of this level of instruction, you should be able to:

1. Describe the information needed to determine start-up costs for a business.
2. Explain the difference between equity and debt financing.
3. Describe alternative sources of financing small businesses.
4. Describe the information that should be included in a business plan.
5. Describe three financial statements needed for developing a business plan.

SUBSTANTIVE INFORMATION

DETERMINING CAPITAL NEEDS

HOW DO YOU MAKE YOUR BUSINESS ASPIRATIONS BECOME REALITIES?

How can you make your dream of opening your own business become a reality? You must think about your business in terms of dollars and cents. It is going to take money to open the business and financial preparation is all-important.

Having enough capital is crucial to business success. Every business must have enough funds from income, including sales and interest from reserve capital, to cover monthly operating expenses as well as inventory and equipment purchases, credit sales if you extend customer credit, and emergency needs.

Where do you begin? You should start by developing a business plan that includes financial statements. A written business plan simply explains what your business venture will be like and describes how you intend to operate it. Information concerning start-up costs, operating expenses, personal living costs, and net worth will help you prepare the reports needed to develop a workable plan, at least in financial terms. These financial reports will help you prepare for the first lean months of your new venture. Preparation of the business plan and financial statements will be discussed later in this level.

Make a list of your probable business and personal needs and their costs. Then compare your costs with the actual costs of operating a business similar to the one you are expecting to open. Be sure to check your needs with your available funds. Do you have the funds required? For the time being, don't concern yourself with determining where the funds will come from; concentrate solely on determining what the necessary funds are.

You need to make a list of needs and probable costs. Your list should answer the following questions:

- How much will it cost you to start up your business?
- How much start-up cash is available to you without borrowing?
- How much money will it take to operate the business for the first year?
- What are your living expenses?
- What is your net worth?
- How much income will the business generate?

In sum, you need to estimate the overall start-up costs, in addition to the operating costs once the business gets going. It is not necessary to make a wild guess. Reasonable estimates can be obtained by gathering information from a variety of sources, and through doing the activities necessary to open your business.

One-Time Only Business Costs

WHAT ARE ONE-TIME BUSINESS COSTS?

Whether you are starting up a new operation, or purchasing an existing business, you will want to estimate your one-time costs. One-time or start-up costs are those expenses that will occur only once. One-time costs might include the following:

- Fixtures and equipment
- Starting inventory
- Decorating and/or remodeling
- Installation of equipment
- Office supplies
- Deposits for utilities
- Legal and professional fees
- Licenses and permits
- Advertising for opening
- Accounts receivable (if applicable)
- Operating cash

(Adapted from Business Plan For Retailers)

Knowing these one-time costs will give you some idea of what your profit must be to simply recover your initial investment (see Exhibit A). These costs should become an important part of your financial planning and represent a starting point. Later you will decide how to amortize these costs over one or more years, depending upon your plan to recover this investment.

Exhibit A

START-UP COSTS
MONEY NEEDS FOR FIRST THREE MONTHS

LIVING EXPENSES	From last paycheck to opening day	$______
	Moving expense	$______
	For three months after opening day (from cost-of-living budget)	$______
DEPOSITS, PREPAYMENTS, LICENSES	Last month's business rent (1st three months in operating expenses below)	$______
	Telephone and utility deposits	$______
	Sales tax deposit	$______
	Business licenses	$______
	Insurance premiums	$______
LEASEHOLD IMPROVEMENTS	Remodeling and redecorating	$______
	Fixtures, equipment, displays	$______
	Installation labor	$______
	Signs--outside and inside	$______
INVENTORY	Service, delivery equipment, and supplies	$______
	Merchandise (approximately 65% of this amount to be invested in opening stock)	$______
TOTAL OPERATING EXPENSES FOR THREE MONTHS (Taken from projected profit & loss statement)		$______
RESERVE TO CARRY CUSTOMERS' ACCOUNTS		$______
CASH FOR PETTY CASH, CHANGE, ETC.		$______
	TOTAL	$______

Operating Expenses

WHAT ARE FIRST YEAR OPERATING EXPENSES?

To estimate your first year's expenses, you will need to calculate operating expenses. These are the expenses necessary in operating the entire business on a month-to-month or year-to-year basis. You should also include start-up costs for at least the first three months, and preferably for the first year. These projections include the following:

- Inventory
- Rent
- Utilities/phone
- Supplies
- Advertising
- Delivery expense
- Repairs
- Insurance
- Taxes
- Loan repayments

Personal Living Expenses

HOW IMPORTANT IS IT TO KNOW YOUR PERSONAL LIVING EXPENSES?

Your business income must be greater than your operating expenses if your business is to succeed. You must show a profit if your business is going to grow. One of the factors that will determine how much income your business must generate to survive will be the minimum salary you need to earn from the business to cover your personal living expenses.

At first, your business income may be very small; so to meet the required business expenses, you may need another source of income or you may find you need to cut living expenses. Consider the experience of one couple who successfully opened a health food restaurant:

> *The first month the restaurant grossed about $4,000 against $2,700 in the cost of the food (cost of sales) and $1,200 to $1,300 in overhead (not including any salary for the owners). Diana continued her medical office job, and paid the household bills ...*
>
> *Six months after they opened the door, they were showing a profit--an extraordinary situation for most new businesses ...*
>
> *The restaurant's sales continued t grow. By June, Jim began to draw a monthly salary of $1,200, which at this stage was considered the restaurant's profit. Previously, he had paid himself varying amounts as the cash flow allowed and their household operating costs required.*
> (Changing Times, The Kiplinger Magazine, June 1977 pg. 26) Reprinted by permission from Changing Times, The Kiplinger Magazine, June 1977 issue. Copyright 1977 by The Kiplinger Washington Editors, Inc., 1729 H. Street, NW, Washington, DC 20006.

Just how much do you require for living expenses each month? When you figure your monthly expenses, you will want to include the following types of information:

- Regular monthly payments such as rent or house payments, car payments, and health or life insurance payments
- Household operating expenses including gas, electricity, telephone, and water expenses
- Monthly food allowance including meals away from home

- Personal expenses including medical expenses, clothing, newspapers, auto expenses, gifts, etc.
- Tax expenses.

There are many different formats which you can use to determine your cost-of-living expenses. Exhibit B will provide you with a summary of your living expenses. This information will help you determine if you can afford to open a business.

Financial advisors suggest that you will feel more comfortable about your first few months in business if you have set aside a minimum of three months' living expenses. Many advisors state that, on the average, businesses take between three to nine months before they can begin to show enough profit to support the personal living expenses of the owners.

Personal Net Worth

WHAT IS PERSONAL NET WORTH?

It is important to determine net worth because you may be investing some of your own capital in the business in addition to borrowing money. Lenders will want to know your net worth. Determining net worth involves preparing a financial statement which answers the question, "How much am I worth financially?"

Exhibit B

COST-OF-LIVING BUDGET

Based on average month--does not cover purchase of any new items except emergency replacements.

DETAILED BUDGET

Regular Monthly Payments

Rent or House Payments (including taxes) $ ______

Car Payments (including insurance) ______

Appliances/TV Payments ______

Home Improvement Loan Payments ______

Personal Loan Payments ______

Health Plan Payments ______

Life Insurance Premiums ______

Other Insurance Premiums ______

Miscellaneous Payments ______

TOTAL $ ______

Household Operating Expense

Telephone ______

Gas and Electricity ______

Water ______

Other Household Expenses, Repairs, Maintenance ______

TOTAL $ ______

Food Expense

Food-At Home ______

Food-Away From Home ______

TOTAL $ ______

Personal Expense

Clothing, Cleaning, Laundry, Shoe Repair ______

Drugs ______

Doctors and Dentists ______

Education ______

Dues ______

Gifts and Contributions ______

Travel ______

Newspapers, Magazines, Books ______

Auto Upkeep, Gas and Parking ______

Spending Money, Allowances ______

TOTAL $ ______

Exhibit B (continued)

Tax Expense		*BUDGET SUMMARY*	
Federal and State Income Taxes	$_______	*Regular Monthly Payments*	$_______
Personal Property Taxes	$_______	*Household Operating Expense*	$_______
Other Taxes	$_______	*Food Expense*	$_______
TOTAL	$_______	*Personal Expense*	$_______
		Tax Expense	$_______
		MONTHLY TOTAL	$_______

Your net worth is determined by subtracting your liabilities (what you owe) from your assets (what you own). In figuring your assets, you should include available cash from bank accounts in addition to the following: real estate, furniture, (paid) value of your car, cash value of life insurance policies, and interest accrued on savings and bonds.

Liabilities include current household bills and balances on installment contracts, such as the car loan, real estate mortgage, and other loans. Exhibit C is an example of a personal financial statement. It is an important document which is used when applying for a loan.

Exhibit C

PERSONAL FINANCIAL STATEMENT
BALANCE SHEET

__________ _____, 19 __

ASSETS Everything you own with cash value

Cash Money you have on hand and in the bank	$________
Savings Accounts	$________
Stocks, Bonds, Other Securities	$________
Accounts/Notes Receivable	$________
Life Insurance Cash Value	$________
Rebates/Refunds	$________
Autos/Other Vehicles	$________
Real Estate	$________
Vested Pension Plan/Retirement Accounts	$________
Other Assets: furnishings, appliances, jewelry, furs, cameras, tools, pets, trusts, etc.	$________
TOTAL ASSETS	$________

LIABILITIES What you owe; your debts

Accounts Payable	$________
Contracts Payable	$________
Notes Payable	$________
Taxes	$________
Real Estate Loans	$________
Other Liabilities: court-demanded payments, etc.	$________
TOTAL LIABILITIES	$________

TOTAL ASSETS $________________

LESS TOTAL LIABILITIES $________________

NET WORTH $________

ARE THERE RESOURCES AVAILABLE FOR ESTIMATING EXPENSES?

Sources of Information

By now you have probably been asking youself, "How do I get the information I need to make realistic estimates?" There are several sources. Other business owners in the field represent one of the major sources of information. Contact your colleagues for answers to such questions as: What is the average monthly sales volume? Does the business field have peak months and low months? What are the typical business costs? What are suppliers charging for goods and services? What are the typical costs for rent, utilities, etc.?

Your library will have government publications, business magazines, trade journals, and books that will give you typical start-up costs and related information for businesses similar to yours. Trade association publications will be quite helpful.

TYPICAL START-UP COSTS

WHAT ARE SOME TYPICAL START-UP COSTS?

How much does it cost to open and operate a plant shop for three months? A bookstore? A TV/radio repair service? A fabric store? Exhibit D illustrates typical start-up costs, operating expenses, and personal living expenses for a hypothetical business, Old Graveyard Antiques:

Exhibit D

OLD GRAVEYARD ANTIQUES

INITIAL INVESTMENT FOR START-UP AND 3 MONTHS' OPERATION

Inventory	$12,000
Equipment and fixtures	5,000
Remodeling of premises	1,500
Rental @ $400/mo.	1,200
Insurance	250
Licenses and taxes	250
Services of professionals (lawyer, accountant, etc.)	250
Wages: part-time employee @ $300/mo.	900
Owner's living expenses @ $700/mo.	2,100
Working capital (i.e., cash on hand to start business)	2,000
Total capital required	$25,[illegible]50

Start-up costs vary considerably depending on the size and nature of the business. Some businesses can be opened "on a shoestring;" others require a bigger investment. For example, a small cleaning business would need relatively little inventory at start-up because it is selling a service rather than a product. On the other hand, a small factory will typically require a much greater investment in equipment and inventory per dollar of expected sales than either a service establishment or a retail store, such as Old Graveyard Antiques.

Franchise operations, which sell local outlets of their retail or service firms to entrepreneurs, have varying start-up costs. The purchase price may be paid in one sum, or as "monthly percentage of sales," or a combination of these arrangements. Often, the price of franchise outlets of small companies is within the range of the beginning entrepreneur. However, such well-known names as McDonald's, Kentucky Fried Chicken, and Holiday Inn now cost a franchisee hundreds of thousands of dollars in start-up costs. Sample start-up costs for franchises are listed below:

Exhibit E

SAMPLE FRANCHISE COSTS

Type of business	Average 1977 sales of franchise units ($000)	Median start-up cash required ($000)
Tax preparation service	23	3
Fast food restaurants	335	30
Hotels and motels	852	100

(Based on Franchising in the Economy 1977-79, Tables 13 and 21, U.S. Department of Commerce, Industry and Trade Administration, 1979.)

FINANCING THE BUSINESS

HOW CAN YOU FINANCE THE BUSINESS?

Now that you've got an overview of the financial investment required, you might wonder, "How will I ever get enough money to start my own business?" Most business owners finance their businesses by using a variety of methods including their own resources and borrowing.

Equity Financing

WHAT IS EQUITY FINANCING?

Equity financing is financing the business with your own funds or the funds of other persons instead of borrowing funds. Any money that you, your friends, relatives, or others invest in your company is equity financing. Private firms who specialize in investing in businesses also provide equity financing. These investors are all buying a piece of ownership in your business. They will want a return on their investment by having a say in how the business is operated and obtaining a percentage or share of the profits.

Debt Financing

WHAT IS DEBT FINANCING?

Debt financing--borrowing money--is another method of obtaining the money needed for the business. The loan must be paid along with interest on the money borrowed. In debt financing you will probably sign a note for the loan and not give up any ownership of the company. Loans will be discussed further on in this level.

Alternate Financing Methods

WHAT ARE OTHER FINANCING METHODS?

Other methods for securing the capital needed include (1) trade credit, (2) economizing, (3) customers, and (4) financing through profits.

Ordinarily, suppliers extend trade credit to their customers, allowing the customers to buy inventory on credit or to buy equipment on installment. Most suppliers extend credit terms on a thirty-day basis, although some suppliers extend forty-five or even sixty-day terms. Shop around for the supplier with good credit terms who carries the goods and services you need for the business. Buying on terms rather than paying cash allows a business to start with less capital.

There are ways to economize on your initial start-up costs. One of the best ways is to lease or to buy used equipment. Trade journals carry classified ads for such equipment. To find used equipment, you can check with used equipment dealers; you can buy demonstrator or loaner equipment; you can search out bankruptcy or liquidation auctions. If cash for operating needs is really limited, you might do a lot of the needed work, such as remodeling, yourself.

In some cases, customers pay for the service or product either when they place the order or on an installment basis, with some of the installments paid before delivery. Magazine subscriptions work this way: when you buy a two-year subscription for a magazine, you are supplying the company with necessary cash before receiving the product. There are similar plans. For instance, customer purchase of memberships in tennis clubs, health spas, or dance studios all supply the business owners with working capital. Industrial purchasers buying heavy equipment made to specifications from manufacturers may pay a down payment plus making installment payments before the product is completed and delivered.

Reinvesting profits in the business is a method often used to finance improvements and business expansion. Naturally this option is not available to you when you first open a business.

OBTAINING A LOAN

DO YOU NEED A LOAN?

Most likely, you will need to apply for a loan to finance part of your start-up costs and your operating expenses. Before you apply for a loan, there are several questions that you need to answer:

- Why do you need the loan?
- How much do you need?
- When do you need the loan?
- For how long will you need it?
- Where will you apply for the loan?
- How can you repay it?

Types of Loans

ARE THERE DIFFERENT TYPES OF LOANS?

There are many different types of loans. For instance, there are short-term, intermediate-term, and long-term loans. Short-term loans, for one year or less, are usually used for operating expenses such as meeting payroll or to pay for merchandise in order to take advantage of the cash discount offered by the supplier. Intermediate loans, which are usually for one to five years, might be used to finance new equipment or to replace long-term indebtedness. Long-term loans are those loans that are taken for five or more years.

General Loan Requirements

WHAT ARE THE REQUIREMENTS TO GET A LOAN?

Loans for start-up capital to open a small business may not be easy to obtain. Most banks and lending institutions will want some evidence that the business has a good chance to succeed before they consider giving a loan. A lender will want to know your own investment in the company; many lenders require that you invest a substantial percentage of your own capital in the business before they will issue a loan. Most banks will not lend over 50% of the money needed.

The lending institution will also want to see your business plan. Therefore, you will need to prepare a written business plan which describes your venture and how you intend to operate it. The plan should include enough information to answer the following:

1. *What will your business do exactly? (Description of service or product and summary of your key goals and objectives.)*
2. *Why will you be successful? (Recognize and list your qualifications, strengths and weaknesses.*
3. *Are you supplying a demand? Or creating one?*
4. *Who--and where--is your market? (Determine sales potential and sources for further research.)*
5. *How will you reach your market?*
6. *Who is your competition and what sets you apart? (Outline their strengths and weaknesses.)*

7. *What are your anticipated selling prices? (Are they competitive, realistic?)*

8. *Where will you locate - home, office, store? (Check local zoning laws if you're considering working at home.)*

9. *What supplies, equipment, raw materials will will you need?*

10. *How will you finance your project?*

11. *What professionals will you consult - accountant, lawyer, banker, etc.?*

(Glamour, March 1977, p. 164) copyright (c) 1977 by the Condè Nast Publications Inc. Claudia Jessup and Genie Chipps are also authors of A Woman's Guide to Starting A Business, Holt, Rinehart and Winston Publishers.

Your business plan should also include financial statements which will help the lender evaluate the plan. At minimum, you will need to prepare three financial statements:

- Estimate of start-up costs, including initial inventory, one-time costs, operating costs, and personal living expenses for three months. You have probably collected much of the information needed to complete this statement. It should be fairly simple to put together a chart showing detailed start-up expenses, as well as total capital needed.
- Projected profit and loss statement
- Forecast of your cash flow for at least three months.

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Profit and Loss Statement

WHAT IS A PROFIT AND LOSS STATEMENT?

The profit and loss statement, also called an income statement, is a financial tool used by a business to compare costs and expenses to sales and other income. It shows the business's profit or loss during a particular time period.

In applying for a loan, you will be using the profit and loss statement differently. You will be estimating or projecting what will happen to your business in the next twelve months. You will be putting together a financial preview of your business so you can compare it to your business goals. A projected profit and loss statement gives the lending institution the information it needs to make a decision about giving your business a loan.

Like other financial statements or forms, the profit and loss statement can be fairly simple or very complex. The five basic areas included in a profit and loss statement are:

- Projected total sales
- Projected cost of goods sold
- Projected gross profit or margin
- Projected operating expenses
- Projected net profit.

Exhibit F is a sample profit and loss statement.

Exhibit F

Projected Profit and Loss (Income) Statement

	Nov.	Dec.	Jan.	Feb.	Total
1. Total Sales	$3,000	$3,500	$1,000	$1,500	$32,000
2. Cost of Goods Sold					
Inventory (beginning)	7,500				
Purchases	- 0 -				
Cost of Goods A[illegible]able for Sale	7,500				
Inventory (ending) (subtract)	7,000				
3. Gross Profit (or margin)	500				
4. Other Operating Expenses					
Salaries	835				
Payroll taxes	215				
Advertising	600				
Supplies	1,000				
Loan Payment	100				
(etc.)					
Total	$5,160				
5. Net Profit	*(4,660)				
*Number in ( ) indicates loss					

Cash Flow Projection

WHAT IS A CASH FLOW PROJECTION?

A cash flow projection is an estimated pattern in which cash will actually come in and go out of the business each month. It will tell the months in which you will need to find additional funds and also when excess cash will be available for further investment and savings for future bills.

The following chart shows the basic information included in a cash flow projection report. According to Exhibit G, you will need to estimate the cash on hand (balance) at the beginning of the first month, the total income from all sources, and the cash outflow to pay expenses.

Exhibit G

CASH FLOW PROJECTION

	Nov.	Dec.	Jan.	Feb.
Sources of Cash				
Cash on Hand				
Cash Receipts				
Sales				
Accounts Receivable				
Payments				
Total Cash Available				
Cash Paid Out				
Salary (Owner's draw)				
Inventory				
Sales Tax				
Overhead				
Selling Expenses				
Payroll & Withholding Taxes				
Total Cash Paid Out				
Cash Balance at End of Month				

Remember the Old Graveyard Antique Shop? Exhibit H is a cash flow projection for three months including the Christmas season:

Exhibit H

	November	December	January
Beginning cash on hand	$1,000	$2,320	$ 640
+ Cash from current month sales	3,000	5,000	3,000
+ Payments on accounts receivable	1,500	1,500	3,000
Total cash available	$5,500	$8,820	$6,640
- Cash disbursements:			
Inventory purchases	$1,000	$6,000	$ -
Owner salary	1,250	1,250	1,250
Employee wages	300	300	300
Rental	400	400	400
Insurance (quarterly)	-	-	250
Miscellaneous cash expenses	230	230	230
Total cash disbursements	$3,180	$8,180	$2,430
End-of-month cash on hand	$2,320	$ 640	$4,210

Even though the December month with the Christmas season is the most profitable month of the year, the cash balance at the end of the month is only $640 compared with $2,320 at December 1. This situation occurred because the business purchased a lot of inventory in November on thirty days' credit and did not pay for the merchandise until December.

Because of such differences in timing as in the above example, cash flow does not equal profit. Although the profit and loss projection is a useful tool to give you a picture of what your business should look like during a specific period of time, it does not tell you how much cash will actually be available to the business. Therefore, both types of financial statements are necessary to portray the financial plans of your business.

EXPOSURE ACTIVITIES

As you have just read, financing is very important to you as you start your business. Now that you have learned some skills on how to finance a business, try these activities. They will help you become more knowledgeable about the financing process.

ASSESSMENT ONE

Do you know the financial responsibilities involved in starting a business? Are you prepared to make the necessary adjustments in your lifestyle? Will you plan ahead to make sure your finances are sound? A self-test follows. If you can label most of the statements "true," you have a good grasp of your finances.

True	False	
_____	_____	I have a head for figures and have looked into my own--and the proposed business'--financial picture thoroughly, preparing all the necessary statements and projections.
_____	_____	I have enough money to go into the business I want and can get more from other sources--friends, family, life insurance company.
_____	_____	I know that my standard of living will be lowered for several months--perhaps even a year or two--until the business begins to show a profit. And I may spend the rest of my life barely "making a go" of it.
_____	_____	I know that the money I borrow must be paid back out of profits, after taxes and before I can take any money out for myself beyond a living wage.
_____	_____	I know that it's possible for me to lose my savings--as well as the money I borrow from others--and that even if the business fails, I must pay back all I owe.
_____	_____	I've always protected myself, my family and possessions with insurance and will continue to do so. My insurance agent will help me select the best protection for the business.

ASSESSMENT TWO

1. Fill in the following missing words. Answers are upside-down on the next page.

   a. Money used for one-time-only costs to begin the business is called ___________ capital.

   b. Money borrowed with a promise to repay with interest is a ___________.

c. Money used to run the business is called

__________ capital.

d. Capital invested in the business is called

__________ capital.

e. Borrowed capital is ______________________

financing.

f. Financing obtained from suppliers is

__________ __________.

g. To cut start-up costs and operating

expenses you may need to ________________.

h. One way to cut down on expenses may be

to rent or _____________ equipment.

i. The statement of actual dollars coming

in and out of a business is the _________

__________ statement.

Answers: a. start-up
b. loan
c. operating
d. equity
e. debt
f. trade credit
g. economize
h. lease
i. cash flow

2. Interview a local banker or savings and loan association officer. Include these questions: Are loans to small businesses easy to get? Has a small business been recently financed by your lending institution? If so, what type of business was it? What did the owner need to prepare in terms of financial reports? If a prospective small business was recently denied a loan by your institution, why?

POSTASSESSMENT

1. List all the expenses which should be considered when describing start-up costs.
2. How would you determine your net worth? Show your calculations in your explanation.
3. Identify sources you would consult to get the information you need to prepare various financial statements.
4. Explain the difference between equity financing and debt financing.
5. What is a business plan? Discuss the information a business plan ought to include.

Compare your answers to your responses to the preassessment. You may want to check your postassessment answers with your instructor.

SELF-EVALUATION

How well did you know the information needed to do the activities?

( ) Very well

( ) Fairly well

( ) A little.

Be honest with yourself. If you feel you don't know the material well enough, it might be helpful to review this section before going on.

EXPLORATION

EXPLORATION

PART II, UNIT F
HOW TO FINANCE THE BUSINESS

PREASSESSMENT

Here are some questions that test for knowledge of the contents of this level. If you are very familiar with the information needed to answer them, perhaps you should go to another level or unit -- check with your instructor. Otherwise, jot down your answers. After you've read through this level, take the postassessment at the end of the "Exploration Activities" section and measure what you've learned.

1. What are fixed costs? Variable costs?
2. What kind of information will you need to determine start-up costs for your business? How will you pay for these costs?
3. Name some sources for business loans.
4. Define the following:
    a. Profit and loss statements
    b. Cash flow projections
    c. Balance sheet statements.
5. "It is not uncommon to find lending institutions unwilling to make loans if the owner has only a minimal investm in the business." Why do you think lending institutions might feel this way?

TEACHING/LEARNING OBJECTIVES

Upon completion of this unit, you should be able to:

1. Explain how to determine start-up costs for a business.
2. Identify fixed and variable costs.
3. Explain the difference between equity financing, debt financing, and trade credit.
4. Describe alternative sources for loans.
5. Explain why the business owner will need to invest personal funds in the business.
6. Describe these financial reports 1) balance sheet, 2) profit and loss statement, and 3) cash flow projections.

SUBSTANTIVE INFORMATION

DETERMINING CAPITAL NEEDS

HOW ARE CAPITAL NEEDS DETERMINED?

The days when you could open a business with twenty-five dollars and a desire to succeed are gone. You can start a few small businesses on a shoestring budget, but others require much more capital than you might imagine. Today's business owner not only needs the desire to succeed and a willingness to do a lot of hard work, but also the knowledge of how to plan for capital needs and how to manage finances.

You should begin to determine the capital needs of the business as soon as you decide to become an entrepreneur. You should begin collecting information to answer the following questions:

- How much will start-up costs be?
- What are my monthly living expenses?
- How much money will be needed to operate the business for the first three months, for the first year?
- How much initial or start-up capital is available without borrowing?
- What is the projected business income?

The information that you collect to answer these questions will provide the basis for completing financial statements on your business. These financial statements will probably be needed when approaching a lending institution for a loan.

Start-Up Costs

WHAT IS INCLUDED IN START-UP COSTS?

Start-up costs are those expenses that will occur only once. These include items such as initial inventory, licenses and permits, and fixtures and equipment. Collecting current local estimates of what it will cost to prepare a business site is fairly easy. Real estate brokers can tell you how much you'll have to pay for a suitable building. Contractors and vendors (suppliers) can give you cost figures for remodeling, fixtures, equipment, inventory, and office furniture or store supplies.

Investigate the cost of the items using the following checklist to estimate start-up costs for your business. These figures are an important part of your financial plan. Be sure to get cost estimates from various sources. For example, compare costs of leasing equipment or buying used equipment with the costs of buying new equipment.

Start-Up Expenses

_____________ Fixtures and Equipment

_____________ Parts and Materials

_____________ Starting Inventory

_____________ Decorating and/or Remodeling

_____________ Installation of Equipment

_______________ Deposits for Utilities

_______________ Legal and Professional Fees

_______________ Licenses and Permits

_______________ Advertising for Opening

_______________ Accounts Receivable (if applicable)

_______________ Operating Cash

_______________ Office Supplies

(Adapted from Business Plans for Retailers, Feb. 1975)

How much capital do you think you would need to open a shoe repair service? A bookstore? Or a TV/radio repair shop? Start up costs vary from business to business. Service firms, which usually need a low initial investment, are not as expensive to open as retail stores with large inventories. Some businesses require significantly more capital than others. For example, it takes several thousands of dollars more to open a fabric store than an appliance store.

Exhibit E illustrates an example of start-up costs for a restaurant opened a few years ago by a couple named Russell. Their start-up costs were $13,592, including improvements to the building.

Exhibit I

Start-Up Costs

Leasehold improvements		
Plumbing	*$670*	
Wiring	*380*	
Lumber for interior construction & decorating	*50*	
Coating for floor	*60*	
Miscellaneous decorating supplies	*100*	
Signs (for roof and window)	*300*	
Electric service deposit	*260*	
Phone service deposit	*100*	*$ 1,920*
Fixtures & equipment		
Dining area (tables, chairs, cash register)		*1,500*
Kitchen area (grills, refrigerators, sink, worktables, utensils, etc.)		*7,740*
Lease (first month's rent)		*550*
Food inventory at opening (packaged foods, fresh produce, supplies)		*1,682*
Initial advertising		*60*
Miscellaneous, including licenses		*140*
		$13,592

Start-up costs for another popular form of entrepreneurship, franchising, also vary. However, it is still possible to open a franchise outlet with limited capital. There are more than 1,000 franchise companies of which 82% have 150 or fewer outlets; over 25% have ten or fewer outlets. These smaller franchise outlets may b[illegible]ed with o[illegible]ly [illegible]al investment. On the oth[illegible] hand, it now costs hundreds of thousands of dollars to own a franchise outlet for such well-known companies as McDonald's, Kentucky Fried Chicken, and Holiday Inn. Regardless of the amount of cash needed, the potential owner must raise additional funds to pr[illegible]de the required total investment. So[illegible] of the add[illegible]ional financing include agreements with fran[illegible]ors, loa[illegible]

Exhibit J il[illegible]ustrates [illegible] start-up cash and total investment for a variety of franchised businesses.

Exhibit J

FRANCHISE SALES AND INITIAL COSTS 1977
($000)

Type of Business	1977 Average Franchise Sales per Unit	Median Start-Up Cash	Median Total Investment
Automobile Products/Services	98	15	50
Business Aids and Services: Accounting, Credit, Collection, and General Business Services	38	6	15
Employment Services	218	15	25
Printing and Copying Services	94	10	45
Tax Preparation Services	23	3	4
Miscellaneous Business Services	60	10	20
Construction, Home Improvement, Maintenance and Cleaning Services	79	10	25
Convenience Stores	392	10	60
Educational Products and Services	121	10	60
Fast Food Restaurants	335	30	100
Hotels and Motels	852	100	900
Campgrounds	99	50	200
Laundry and Dry Cleaning Services	81	16	50
Recreation, Entertainment [illegible] Travel	51	15	30
Rental Services (Auto-Truck)	168	40	100
Rental Services (Equipment)	102	10	50
Retailing (Non-Food)	223	25	50
Retailing, Food (Other than Convenience Stores)	152	21	60
Miscellaneous	221	10	38

(<u>Franchising in the Economy 1977-79</u>, Tables 13 and 21)

DETERMINING OPERATING EXPENSES

HOW DO YOU DETERMINE OPERATING EXPENSES?

How much capital will you need to carry you through the first three months? What will be your operating expenses for the first year? What information will you need to project your monthly operating expenses? These may not be easy questions, but the estimated answers will prove very important in developing a workable plan for your business. To begin, you will need to have information about variable and fixed expenses.

Variable expenses--those expenses that do change--and include such items as:

- Salaries
- Payroll taxes (dependent on salaries)
- Advertising
- Delivery expenses (if applicable)
- Legal and accounting costs
- Office supplies
- Telephone
- Utilities
- Inventory

Fixed expenses--those expenses that will remain fairly constant--and include such items as:

- Insurance
- Rent
- Taxes and licenses
- Loan payments .

Personal Living Expenses

WHAT ARE YOUR PERSONAL LIVING EXPENSES?

You should have enough initial capital to cover not only start-up expenses and initial operating expenses, but also personal living expenses until the business begins to break even or make a profit. This could take from three to four months to a year.

Many financial advisors suggest that you should have at least three months' living expenses set aside in the bank. Many owners start a business while holding another job or the spouse may work to cover the personal living expenses. The easiest item to cut in the budget of a beginning business is the owner's salary.

What are your basic needs for one month? You will want to prepare a detailed budget and include items found in the sample budget below and on the following pages (Exhibit K).

Exhibit K

Personal Budget Outline		
I	Monthly Payments	
	Rent or mortgage	$ ________
	Car payments	________
	Insurance	________
	Other	________
	Total	$ ________

II	Household	
	Telephone	$ ________
	Electricity	________
	[illegible]	________
	[illegible]	________
	Other	________
	Total	$ ________
III	Food expenses	
	Home	$ ________
	Away from home	________
	Total	$ ________
IV	Personal expenses	
	Clothing upkeep	$ ________
	Drugs	________
	Doctors/dentists	________
	Gifts	________
	Newspaper/magazines	________
	Gas	________
	Spending money	________
	Other	________
	Total	$ ________

V	Tax expenses		
	Federal	$	____
	State		____
	Property		____
	Other		____
	Total	$	____
VI	Monthly Total	$	____

Projecting Business Income

WHAT IS YOUR PROJECTED BUSINESS INCOME?

You are in business to make a profit. Do you have any idea of how much income the business will generate? Just as you made estimates of expenses, you will need to make estimates of income. First, you will need to gather information in order to estimate the prices of the products or service that you are going to sell. Second, you need to get more information on the nature of the market.

Regardless of the type of venture, you may find your business subject to seasonal influences. If you manufacture canoes, what months produce the highest sales volume? If you are in the construction business, is there a season that is "lean" and a season when many contracts are signed?

Sources of Information

WHERE DO YOU GET THE INFORMATION?

How do you make realistic estimates of your start-up costs, operating expenses, and projected income? First, if you are familiar with the business area you are entering, you probably already have a good idea of some of the estimates. Finding the information you need will take some time, if you want to gather accurate and useful data.

To help you make realistic estimates of costs that are general to your type of business, you can consult several sources. Ask other business owners what their operating expenses and costs are. Your bank can provide you with copies of resources that give expense and income information. A good public or college library will also have helpful reference materials.

You may not be able to find all the answers immediately on expenses related only to your particular business venture. Rent and the cost of utilities will depend on the site you finally choose after considering several options. Advertising costs will be determined after you learn more about your advertising needs and local costs. You will want to check with several suppliers to find the best terms available to you.

FINANCING THE BUSINESS

HOW CAN YOU FINANCE THE BUSINESS?

How can you finance the opening and operation of your business? First, you must determine how much of your own money you can invest in the firm and offer as a backing for other financing. Make out a personal balance sheet that contains the information listed in Exhibit L. Your net worth will tell you (and your banker) what you yourself can invest.

Unless you are in a very fortunate position, your own finances alone won't be enough to open your business. Where can you get help? Two basic approaches are available: equity and debt financing. Most business owners use a combination of the two for their capital needs.

Equity Financing

WHAT IS EQUITY FINANCING?

Equity financing refers to any investment you or others make in your business. If you are the sole proprietor, the only equity financing is your own investment in the company. If you are operating a partnership, the other partners will have also invested in the company. If you have decided to incorporate the business, not only you but also the stockholders have invested in the company. Investment by others in your company means a sharing of the ownership in and the control of the company. Profits received by the company are also distributed among the investors.

Debt Financing

WHAT IS DEBT FINANCING?

Debt financing is another way of raising capital for your business. Debt financing is borrowed capital. To obtain debt financing, you must apply and be approved for a loan. A business loan is like any other loan in that it must be repaid to

Exhibit L

PERSONAL BALANCE SHEET STATEMENT

________________ ______ 19 ___

ASSETS: Everything you own with cash value

Cash Money you have on hand and in the bank	$_______
Savings Accounts	$_______
Stocks, Bonds, Other Securities	$_______
Accounts/Notes Receivable	$_______
Life Insurance Cash Value	$_______
Rebates/Refunds	$_______
Autos/Other Vehicles	$_______
Real Estate	$_______
Vested Pension Plan/Retirement Accounts	$_______
Other Assets Furnishings, appliances, jewelry, furs, cameras, tools, pets, trusts, etc.	$_______
TOTAL ASSETS	$_______

LIABILITIES: What you owe: your debts

Accounts Payable	$_______
Contracts Payable	$_______
Notes Payable	$_______
Taxes	$_______
Real Estate Loans	$_______
Other Liabilities (Court-demanded payments, etc.)	$_______
TOTAL LIABILITIES	$_______

TOTAL ASSETS $_______

LESS TOTAL LIABILITIES $_______

NET WORTH $_______

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the lending institution or lender with interest within a specified period of time. The loan payments are considered a fixed operating expense. When the loan is paid in full, the obligation is completed.

Financing Alternatives

ARE THERE OTHER WAYS TO FINANCE THE BUSINESS?

In addition to equity and deb inancing, there are other ways to finance the start-up and the operating costs of a business. Trade credit, economizing, customers, and profits are all alternative financial sources.

One of the largest sources of small business financing is trade credit used when purchasing from trade sources. Your suppliers may extend credit for purchasing merchandise, supplies, and equipment. This credit is short-term financing since the repayment terms may be for thirty, forty-five, sixty, or ninety days. At times, suppliers offer a discount for prompt payment, and interest may not be charged if payment is made during the agreed time period.

Trade credit is an important source of financing. It will continue for your firm only as long as your firm maintains good relations with vendors and a good credit rating by paying bills on time. Talk with your suppliers. What are the best extended credit terms you can negotiate? When feasible, try to secure competitive bids from various suppliers.

There are many ways and methods of economizing on expenses. Lowering your firm's operating expenses could mean emptying your own trash or shopping around for the best prices when purchasing services and equipment.

When trying to discover ways of economizing, you will want to look at both start-up expenses and operating costs. You may find that office equipment, manufacturing equipment, and fixtures were fairly expensive. You may be able to cut these initial costs by leasing necessary equipment and fixtures. Or, if you cannot find agreeable terms for leasing, consider buying used equipment, demonstrator or loaner equipment, or bankruptcy or liquidation sale equipment and fixtures.

There are many sources for used equipment and fixtures, such as:

- Yellow pages of the phone directory under "Used Equipment Dealers," "Second Hand Dealers," "Surplus Merchandise," and "Office Furniture-Used"
- Yellow pages under "Auctions" or "Auctioneers" to receive information on forthcoming auctions
- Trade journal classified ads on liquidation sales or closeout sales
- U. S. Government surplus sales. Write to the Defense Surplus Sales Office or General Services Administration, 7th & D Street, SW, Washington, DC. They can inform you of auctions and surplus sales dates and locations.

Contact local representatives of these agencies by checking your phone bood under "U.S. Government."

- Most states also have surplus sales. You should contact your own state agency for specific information.

Would customers finance your untried business? Whether you realize it or not, you finance other businesses all the time. Every time you buy a magazine subscription, you are paying for products not yet available, but promised. If you have ever bought membership in a swim club, a racquetball club, a tennis club, or a health spa, you have paid for services yet to be received. You have probably bought a manufactured product with a down payment, a second payment before the product was completed, and a third payment when the product was finished. Perhaps you can think of some way your customers could help finance your business.

Profits can be reinvested in your company. Most often profits are reinvested to finance expanding the business site and making facility improvements. This is one source of financing that is not available to a new business. It will take time for a new business to make a profit.

GETTING A LOAN

DO YOU NEED A LOAN?

The decision t take out a loan is usually based upon an estimate of start-up expenses, beginning operating expenses, and the personal balance sheet. Other factors which are considered include determination of how much personal equity you, the entrepreneur, can invest in the company, and how many "corners" can be cut on expenses. Suppliers also need to be consulted for estimates on trade credit. If, after all this, you still do not have enough initial capital, you may decide that you need to borrow money.

Before you apply for a loan, there are several questions that you should answer. You need to decide what kind of loan you want to apply for, whether short-term, intermediate-term, or long-term, and where you want to seek a loan. You also need to answer the questions below:

- Why do you need the loan?
- How much capital do you need?
- When do you need the loan?
- For how long will you need it?
- How will you repay the loan?

Answering these questions will let the loan officers know that you have studied financing for your business.

Sources of Loans

WHAT ARE THE SOURCES OF LOANS?

Loans are not easily obtained by the beginning entrepreneur. The old saying, "You've got to have money before you can get money," is appropriate for this situation. There are a variety of approaches that can be used to borrow funds. The list below indicates several sources worth investigating.

- Life insurance companies
- Market value of securities or other investments owned
- Personal finance companies
- Commercial finance companies
- Commercial banks
- Savings and loan associations
- Small Business Administration (SBA)
- Small Business Investment Companies (SBIC).

Probably the most difficult loan to obtain would be a bank loan or a loan from some other lending institution. This will be discussed further in the next section.

SBA loans are made to small businesses only. SBA defines a small business as one that is individually owned and operated, not dominant in its field, and meets employment and sales standards defined by the agency. Businesses are small if they operate within these standards (1) manufacturing--up to

1,500 employees, (2) wholesaling--yearly sales not over $9.5 to $22 million, (3) service--annual sales not exceeding $2 to $8 million, (4) retailing--annual sales not over $2 to $7.5 million, and (5) agriculture--annual receipts not exceeding $275,000. To be eligible for a regular loan from the SBA, you must have been turned down by two banks. The SBA provides many different kinds of loans. These loans include Economic Opportunity Loans, Pool Loans, Revolving Lines of Credit, and Handicapped Assistance Loans. To investigate these loans, contact your local SBA office.

The Small Business Investment Companies (SBIC) are privately organized and managed loan firms that are licensed by the SBA. For more information, write the National Association of Small Business Investment Companies, 512 Washington Building, Washington, DC 20005.

INFORMATION REQUIRED BY LENDING INSTITUTIONS

WHAT INFORMATION IS NEEDED BY LENDING INSTITUTIONS?

Because it is not easy to obtain a loan from lending instututions for a new small business, there are several things that you must do. To begin, you need to prove that you know about your business and about financing, which may increase your chances of getting that needed loan. In addition to the information in your business plan, you should include certain financial statements. These are (1) a statement of start-up costs, including one-time expenditures and three ... operating costs; (2) a projected profit and loss statement: and (3) a projected cash flow statement.

In addition to the business plan and financial statements, the lending institution will be taking a look at your background, including your experience in business, your personal net worth, and the amount of equity that you plant to invest in the business. In terms of the latter, you need to show that your own personal funds will contribute to the initial funding more heavily than those of others, whatever the source. The rationale seems to be that if you do not consider the business worth investing in, why should others? Lending institutions also believe that you will operate the firm with greater care. In many cases, you will be asked to match the amount of money you are requesting to borrow.

Financial Statement or Start-Up Costs

DO YOU KNOW YOUR START-UP COSTS?

Based on information given earlier in this level, you have a fairly good idea on how to compile your start-up costs and your operating expenses. You have chosen a site and have collected data on overhead costs. You have shopped around for the best credit deals on supplies, inventory, and equipment. You have figured out where you can cut costs by doing certain start-up and operating jobs yourself. This information should be put into a financial statement for the lending institution.

[illegible] shows the actual start-up costs of a telephone interconnect company. This firm's largest single expense was inventory, followed by employee training. Why do you think such a sizeable investement for training was necessary? Could the training costs have been reduced?

Exhibit M

ACTUAL START-UP COSTS OF
TELEPHONE INTERCONNECT COMPANY

	Amount to nearest $
Rent - 1st month	$ 150
Legal fees	470
Improvements - paneling, paint, carpet	550
Utility deposits	95
Licenses	60
Printing	325
Magazine subscriptions	46
Materials for benches and work area	200
Insurance	92
Inventories	1,360
Office equipment and furniture	710
Employee training	860
Bell Telephone installation of required equipment and one month's bill	546
Total	$5,424

Exhibit N shows the same company's monthly expense projections, from which it can estimate the costs for the first three months of operation. What figures now constitute the bulk of total expenses? What differences do you note between start-up costs and regular monthly expenses?

Exhibit N

PROJECTED MONTHLY COSTS OF
TELEPHONE INTERCONNECT COMPANY

	Estimated
Rent	$150
Utilities	75
Telephone	134
Parking garage	20
Insurance	25
Advertising	50
Office expense	50
Travel	-0-
CPA fees	-0-
Employee training	100
Interest	80
Company Vehicle - Van	-0-
Miscellaneous and Unexpected	-0-
Salaries:	
Manager	1,200
Installation supervisor	1,000
Installer	800
Secretary/bookkeeper	500
Total	$4,209

Projected Profit and Loss Statement

WHAT IS A PROJECTED PROFIT AND LOSS STATEMENT?

The projected profit and loss statement, also called an income statement, is like a photograph. It shows you how to expect your business to look during a particular period of time. It is a summary of the business activites affecting profit and loss; it compares costs and expenses to sales and revenue to show profit or loss.

There are five main parts to a projected profit and loss statement (1) total sales, (2) cost of goods sold, (3) gross profit, (4) expenses, and (5) net profit. The relationship between these five parts is defined by (1) total sales less actual cost of the merchandise sold equals gross prift (gross margin); and (2) gross profit less operating expenses, which includes all expenses other than merchandise costs, equals net profit before taxes. If you have been collecting cost data, you probably have the information needed to estimate these expenses. (See Exhibit O for sample chart.)

If you wish to own a manufacturing business, calculating the cost of goods sold will be more complicated than it would be for a retail or service business. You will need to calculate the following in your projected cost of goods sold: raw materials inventory, goods-in-process inventory, finished goods inventory, and direct labor and overhead costs.

Exhibit O

SAMPLE CHART FOR

PROJECTED PROFIT AND LOSS STATEMENT

	Jan	Feb	Mar	Apr	May	June
Total Sales Cash Credit						
Total						
Cost of Goods Sold Inventory (beginning) Purchases Cost of Goods Available for Sale Inventory (ending) (substract)						
Gross Profit						
Administrative Expenses Salaries Payroll taxes Advertising Supplies Loan payment (etc.)						
Total						
Net Profit (Loss)						

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For example, the Old Graveyard Antiques shop has estimated its total annual expenses to be $28,150. A chart for the projected profit and loss statement of the shop is shown in Exhibit P.

Exhibit P

OPERATING INCOME AND EXPENSES
OLD GRAVEYARD ANTIQUES

	Annual	Average Monthly
Total Sales	$75,000	$ 6,250
- Cost of Goods Sold	37,500	3,125
= Gross Profit	$37,500	$ 3,125
- Expenses:		
Owner Salary	$15,000	$ 1,250
Employee Wages	3,600	300
Rent	4,800	400
Utilities	900	75
Advertising	600	50
Insurance	1,000	83
Professional Services	750	62
Depreciation	500	42
Miscellaneous Expenses	1,000	83
Total Expenses	$28,150	$ 2,345
= Net Profit before Taxes	$ 9,350	$ 780

Projected Cash Flow Statement

WHAT IS IN THE PROJECTED CASH FLOW STATEMENT?

Once you begin the business, you will be asking questions like, "Will sales bring in enough cash to pay bills due?" or "Weill there be enough cash to keep the business going until the next contract comes in?" The cash flow forecast will help answer these questions before you open your business so you can better plan your business's financial condition. A cash flow projection will point out if you have sufficient funds from sales income and your capital reserve to cover not only monthly operating expenses but also periodic inventory and equipment purchases, credit sales (if you extend credit to customers), and contingency cash needs. You can use the cash flow forecast to plan for "lean" months and to determine when there will be enough cash surplus to reinvest in the business or make other investments.

Exhibit Q is an example of a cash flow projection for the Old Graveyard Antique Shop. The bottom line shows the cumulative net flow of cash into the firm, month by month.

Exhibit R is a basic form for a cash flow projection. Fill in the information applicable to your business. Do you have all the data you need?

Exhibit Q

SIX MONTH CASH FLOW PROJECTION: OLD GRAVEYARD ANTIQUES

	Nov	Dec	Jan	Feb	Mar	Apr
Beginning cash on hand	$1,000	$2,320	$ 640	$4,210	$3,630	$3,350
+ Cash from sales	3,000	5,000	3,000	2,000	2,000	3,000
+ Payments on accounts receivable	1,500	1,500	3,000	1,600	1,400	1,800
= Total cash available	$5,500	$8,820	$6,640	$7,810	$7,030	$8,150
- Cash disbursements:						
Inventory purchases	$1,000	$6,000	-	$2,000	$1,500	$1,000
Owner salary	1,250	1,250	1,250	1,250	1,250	1,250
Employee wage	300	300	300	300	300	300
Rental	400	400	400	400	400	400
Insurance (quarterly)	-	-	250	-	-	250
Miscellaneous cash expense	230	230	230	230	230	230
Total	$3,180	$8,180	$2,430	$4,180	$3,680	$3,430
= Ending cash on hand	$2,320	$ 640	$4,210	$3,630	$3,350	$4,720
- Beginning cash (line 1)	1,000	2,320	640	4,210	3,630	3,350
= Month's net cash flow	1,320	-1,680	3,570	-580	-280	1,370
Cumulative cash flow	$1,320	$ -360	$3,210	$2,630	$2,350	$3,720

Exhibit R

12-MONTH CASH FLOW
Projections

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12	TOTAL
CASH (beginning of month) Cash on Hand													
Cash in Bank													
Cash in Investments													
Total Cash													
PLUS INCOME (during month) Cash Sales													
Credit Sales Payments													
Investment Income													
Loans													
Other Cash Income													
Total Income													
TOTAL CASH AND INCOME													
EXPENSES (during month) Inventory or New Material													
Wages (including owner's)													
Taxes													
Equipment Expense													
Overhead													
Selling Expense													
Transportation													
Loan Repayment													
Other Cash Expenses													
TOTAL EXPENSES													
CASH FLOW EXCESS (end of month)													
CASH FLOW CUMULATIVE (monthly)													

EXPLORATION ACTIVITIES

Do you feel competent enough in obtaining financing to utilize some of the techniques discussed in the unit? The following activities will help you experience some "real" financing situations and put into practice what you have learned. After completing the activities, do a self-evaluation to check your understanding of the material.

ASSESSMENT ONE

1. List and describe the various financial sources available for starting a business.
2. Interview a loan officer at a local bank or savings and loan institution. Take start-up cost projections, projected profit and loss statements, and projected cash flow statements for your anticipated business with you. Ask the loan officer to review the documents and answer the following candidly 1) Are you in good enough financial condition for a loan? 2) Are the financial reports prepared correctly? 3) What additional data would be needed before the officer could grant you a loan?
3. Project the cash flow for your business operation. Be realistic about sales volume. Use resources such as banks, libraries, and other business persons for the information you need.

4. Locate two financial institutions such as a bank, credit union, or finance company in your area and arrange to meet with representatives to discuss their policies regarding lending money to new businesses. Note any dollar limitations they may have on loans. Compare your findings. You might want to record your findings on the following chart:

Lending Institution	Funding Policies	Loan Limit	Comparison Notes
1.			
2, etc.			

POSTASSESSMENT

1. Define fixed and variable costs.

2. Describe the information you will need to determine start-up costs for your business. How will you finance these costs?

3. Describe three sources for business loans.

4. Describe the financial statements listed below. What do they tell? What information is included in each?

    a. Profit and loss statements

    b. Cash flow projections

    c. Balance sheet statements.

5. "It is not uncommon to find lending institutions unwilling to make loans if the owner has only a minimal investment in the business." Assume this statement is true and discuss why lending institutions feel this way.

Compare your answers to your responses to the preassessment. You may want to check your postassessment answers with your instructor.

SELF-EVALUATION

How well did you know the information needed to do the activities?

( ) Very well

( ) Fairly well

( ) A little.

Be honest with yourself. If you feel you don't know the material well enough, it might be helpful to review this section before going on.

PREPARATION/ ADAPTATION

PREPARATION/
ADAPTATION

PART II, UNIT F
HOW TO FINANCE
THE BUSINESS

PREASSESSMENT

Here are some questions that test for knowledge of the contents of this level. If you are very familiar with the information needed to answer them, perhaps you should go to another level or unit - check with your instructor. Otherwise, jot down your answers. After you've read through this level, take the postassessment at the end of the "Preparation/Adaptation Activities" section and measure what you've learned.

1. What sources can an entrepreneur consult if he or she wants to estimate business expenses and sales volume?
2. Do start-up costs vary according to the type of business? Are manufacturing businesses the least expensive to open? Why or why not?
3. Estimate a projected profit and loss statement for the business you are considering owning.
4. Prepare a projected cash flow statement for the business you are considering opening.
5. What are the various means of obtaining the necessary cash? Which might be best for your business? What information will you need to provide a lending institution if you want to obtain a loan?

TEACHING/LEARNING OBJECTIVES

Upon completion of this level of instruction you should be able to:

1. Determine capital needs for your business venture.
2. Prepare a projected profit and loss statement and a projected cash flow statement for your business.
3. Describe sources of information available to help you prepare financial reports for your firm.
4. Describe the type of information you will need about your business to obtain a loan.

SUBSTANTIVE INFORMATION

DETERMINING CAPITAL NEEDS

HOW CAN YOU DETERMINE CAPITAL NEEDS?

Making a profit is necessary if a business is to succeed, so careful study and investigation of your capital needs is essential. Not only must you estimate how much it will cost to start up your business, but you must also provide figures on how much money will be required to operate it during the first year. Money needs will vary according to the type of business--whether it is manufacturing, wholesaling, retail, or service, and the kind of merchandise or service offered, the income level of your customers, your personal trade connections, the location of your business, general economic conditions at the time of starting the business, and many other factors.

Sources of Information

WHAT ARE SOME SOURCES OF INFORMATION TO HELP ESTIMATE COSTS?

When determining costs, there is no substitute for first-hand knowledge about your prospective business enterprise. It is far better for you to spend a few hours and dollars now to make these initial investigations than to wait and learn through trial and error. Therefore, get all the information you can from other people in the same or a similar business, from trade associations, government agencies, libraries, and other likely sources. Many of these sources may be within your own community.

The following sources can be contacted either by mail or by referring to their publications in your local library:

Dun & Bradstreet
99 Church Street
New York, NY 10007

The Bank of America
Small Business Reporter
Department 3120
P.O. Box 37000
San Francisco, CA 94137

Robert Morris Associates
Philadelphia National Bank Bldg.
Philadelphia, PA 19107

Small Business Administration
Washington D.C. 20416
or a Field Office in your area.
(Ask for catalog 115A and 115B)

National Cash Register Corporation
3095 Kettering Blvd.
1st Floor
Dayton, OH 45439
(Ask for annual "Expense in Retailing" publication).

Other organizations or individuals who may be contacted are:

Colleges and universities
Your own present or potential customers
Trade associations
Chambers of Commerce
Better Business Bureaus
Credit bureaus
Business sections of libraries
Minority economic and business development centers.

The more sources of information that you contact, the more accurate your projection of the capital needs for your business will be. All of the sources listed have an abundance of information, such as typical operating ratios for the kind of business in which you are interested.

Operating Ratios

WHAT ARE OPERATING RATIOS?

One method of comparing and analyzing what your business expenses should be is to use operating ratios. Operating ratios are percentage figures showing what proportions of the sales dollar businesses spend on various components of their operations. For example, the average bookstore with sales of two hundred fifty to five hundred thousand dollars might spend 43% of its sales on wages and salaries. A bookstore owner in this size range who spends 60% of sales in salaries might decied to examine her or his employment policies after finding that the average for similar businesses is 43%.

In order to obtain operating ratios, first find out both the total volume of sales and the operating ratios for businesses like yours. Among the sources for sales volume figures and operating ratios are Bank of America's "Small Statement Studies," Robert Morris Associates' "Annual Statement Studies," Dun & Bradstreet, Inc., trade associations, trade magazines, specialized accounting firms, publications prepared by industrial companies (for example, "Expenses in Retail Business," by National Cash Register Co.) and colleges and universities. Next, determine how sales volume can be broken down into the various categories of expenses and profit.

Once you have the operating ratio information, it is relatively easy to determine expenses. The typical ratios for your type of business multiplied by your estimated sales volume will serve as a benchmark for estimating the various items of expense. However, you should never rely exclusively on this method for estimating each expense item.

Current Assets

WHAT ARE CURRENT ASSETS?

One of the first considerations in financing your business is to determine how much money is needed for inventory, accounts receivable, and of course, cash. All of these will comprise your current assets. To a large extent, your investment in current assets will depend upon what you anticipate your current liabilities to be on the opening day of business. A rule of thumb is that current assets should be twice that of current liabilities.

Needs for Types of Businesses

Retail and Wholesale Firms

HOW CAN CAPITAL NEEDS FOR RETAIL AND WHOLESALE (cont'd)

In estimating inventory requirements for a wholesale or retail business, talk to your prospective suppliers. Such an estimate should be checked against the typical ratio of inventory in relation to sales if you have such a ratio for your kind of business. For example, assume that net sales in your type of business are typically six times inventory. Then, for annual net sales

FIRMS BE ESTIMATED?

of $375,000, your inventory should approximate $62,500. You should make this type of calculation to establish a maximum dollar figure for inventory and not go above it. Otherwise, you or your suppliers might be overenthusiastic about the amount of merchandise you should stock for your initial inventory.

Manufacturing Businesses

HOW CAN CAPITAL NEEDS FOR MANUFACTURERS BE ESTIMATED?

The procedure for estimating the money needed to start a small factory is similar but somewhat more complex. For example, suppose you wish to manufacture an automotive part and hope to make an annual net profit of $20,000. Yearly sales of $500,000 will be necessary, computed at a 4% profit. How many units must be produced to attain this volume? Assume you plan to manufacture one part which will sell for an average of $20.00. To reach a sales volume of $500,000, you must sell 25,000 units. This means an average of 500 units per week for 50 weeks. How much machinery and equipment will be required to produce 500 units per week? How much down payment for the equipment will be necessary? Should you lease some of the equipment? How many operators will be needed? You must add to the equipment costs estimates for materials, wages, rent, sales, office and other expenses for a period necessary to produce enough units for one complete turn; that is, the annual production (25,000 units in the case) divided by the expected number of stock turns per year.

Service Firms

HOW CAN CAPITAL NEEDS FOR A SERVICE FIRM BE ESTIMATED?

Estimating the money needed to st[illegible]t a service establishment will involve a combination of the above methods used for merchandising and manufacturing businesses. To the extent that the service business carries goods for sale, estimates could be made in the manner outlined for wholesale and retail concerns. To the extent that it sells labor or machine work, money needed for equipment and wages could be estimated similar to a factory.

Franchises

WHAT ARE SOME TYPICAL CAPITAL REQUIREMENTS TO OPEN A FRANCHISE?

Holiday Inn, Kentucky Fried Chicken and McDonald's are all familiar franchising organizations. The capital required to purchase an outlet of many of the large, successful franchise organizations can range from hundreds of thousands to several million dollars. Yet some franchise outlets can still be purchased for a few thousand dollars. Those franchises that require the least start-up cash are in the business aids and services area, which is expected to have rapid growth.

The future of franchising is encouraging. In the April 1977 issue, Changing Times reported that even during the recent recession, the franchising field was remarkably successful. Franchising offers a means of becoming an entrepreneur; being your own boss; and profiting from being a part of a big business with national or regional advertising, large-scale purchasing power, and exclusive distribution of name brands. If you can provide the capital, franchising may be the way to own your own business and make a respectable profit.

WHERE CAN INFORMATION BE FOUND ON FRANCHISING?

Information on Franchising. If you are considering opening a franchise, you should check several resources. Write for annual reports and other brochures from the parent company. Ask to be sent disclosure statements. Several publications are good sources for names, addresses, and other details on franchising enterprises. These include: The U.S. Department of Commerce's Franchising Opportunities Handbook, available from the Superintendent of Documents, Washington, D.C. 20402; Classified Directory of Members, available from International Franchise Association, 7315 Wisconsin Avenue, Washington, D.C. 20014. The Small Business Administration booklet, Franchise Index/Profile, available from the Superintendent of Documents, Washington, D.C. 20402, provides step-by-step procedures in opening a franchise outlet: the U.S. Commerce Department's Franchising in the Economy, also available from the Superintendent of Documents, provides current information on trends in the franchising business.

Adequate Capital

HOW IMPORTANT IS IT TO HAVE ADEQUATE CAPITAL?

Regardless of the type of business you open, having adequate capital is very important. The capital you have available to start the business should exceed the estimated cash needed to open the business by a safe margin. You not only need money to get started, but also enough in reserve to carry the business until it becomes self-supporting. This includes enough capital to cover initial inventory and all start-up expenses plus operating and personal expenses until the business begins to break even. In some businesses it may take four to six months; in others it may be much longer.

Undercapitalization is one of the major reasons for business failure. If you do not have sufficient cash, you may be unable to:

1. Afford enough employees to keep the business operating
2. Invest in proper equipment
3. Maintain adequate stock levels of merchandise or materials in order to build sales volume
4. Take advantage of discounts offered by creditors; instead you will be burdened with heavy interest
5. Grant customer credit to meet competition.

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FINANCIAL ESTIMATES AND STATEMENTS

HOW DO YOU PREPARE FINANCIAL ESTIMATES AND STATEMENTS?

In order to prepare financial statements and estimates, you need to gather information regarding typical current assets and current liabilities for the type of business you wish to open.

The worksheet that follows (Exhibit S will help you estimate your one-time start-up costs, your operating expenses, and your projected sales income for your business. The column at the left is a breakdown of these categories. The second column is your estimate of actual figures of the dollars a friend, relative, or business colleague has invested in a similar business. The third column is your estimate of the investment made in a business operated by your principal competition. Competition in this case does not necessarily mean the strongest firm against which you will compete. Rather, it means a business of a similar size that has been engaged in the type of sales or services that you want to establish. The next to the last column is the average of the two firms you surveyed. If possible, make an estimate of more than two competing firms. This will make the average figure more accurate. Much of this information will be difficult to obtain, especially information about a competitor's investment. However, this data is vital and will help you make a more accurate estimate.

Exhibit S

	Friend	Competition	Average	Yours
Initial Capital Requirements				
Purchase of real estate/rent				
Decorating/remodeling				
Fixtures and equipment				
Initial inventory				
Accounts receivable				
Utility deposits				
Initial advertising				
Office supplies				
Installation of equipment				
Legal and professional fees				
Licenses and permits				
Total				
Monthly Operating Expenses				
Salary of owner				
Other salaries				
Rent/mortgage				
Advertising				
Delivery expenses				
Supplies				
Telephone				
Utilities				
Insurance				
Taxes				
Loan repayment				
Travel				
Legal and Professional fees				
Total				

Projected Sales Income

	J	F	M	A	M	J	J	A	S	O	N	D
Friend												
Competition												
Average												
Yours												

Business Expense Worksheet

HOW WILL A WORKSHEET OF EXPENSES HELP?

Completing a worksheet of business expenses (Exhibit T) based on sales will help you prepare a projected profit and loss statement for the first year. There are two key variables which must be determined before the necessary cash requirements can be projected. These are (1) projected sales volume and (2) multiplier. All projections are based on expected or determinable sales volume. Any significant variance from the projected sales volume figure for the year is going to substantially change your cash requirements. Looking at the worksheet, you can see that the middle column is captioned "multiplier." Using a multiplier allows you to build a margin of safety into your estimate. This figure will probably be at least two, and sometimes three or greater, depending upon the type of business, your inventory turnover, and other characteristics of the cash flow in your business. The higher the multiplier the more conservative figure you will get. For safety, the multiplier should be at least two or three. After estimating the monthly expenses and applying the multiplier, you have arrived at an estimated cash figure for a business similar in nature to your own. Work through Exhibit T for your business.

Exhibit T

WORKSHEET OF EXPENSES
BASED ON ANNUAL SALES OF $____

	Estimated Monthly Expense	Multiplier	Cash Needed to Start Business
Owner's Salary			
Other Salaries			
Cost of Goods Sold			
Rent			
Insurance			
Advertising			
Utilities & Telephone			
Interest			
Maintenance & Repairs			
Taxes - Personal property Social Security Real Estate			
Miscellaneous	______		______
Total			

Typical Start-Up Costs

WHAT ARE SOME TYPICAL START-UP COSTS?

Exhibit U on the next page gives some start-up costs for a variety of businesses. These are not to be taken as actual start-up costs but as business averages against which you can compare your estimates. Notice the differences in start-up costs between businesses. You can start some businesses on very little; others require a bigger investment than you might imagine.

Exhibit U

THE MONEY IT TAKES TO GET A SMALL BUSINESS GOING

Type of Business and Annual Gross Sales	Investment In Inventory	Total Capital Investment (For Start-Up and First Three Months' Operation)
Building Maintenance Service $25,000 to $75,000		$8,000 to $16,000
Plant Shop $25,000 to $80,000	$5,000 to $10,000	$11,000 to $24,000
Bookstore $75,000 to $100,000	$12,000 to $20,000	$25,000 to $53,000
Beauty Salon under $100,000		$15,000 to $29,000
Yarn Shop $50,000 to $100,000	$8,000 to $12,000	$16,000 to $25,000
Repair Service		
Furniture		$10,000 to $20,000
Car		15,000 to 40,000
TV/radio		10,000 to 25,000
Appliance		6,000 to 20,000
Clock/watch		8,000 to 12,000
Shoe		15,000 to 25,000
Business machine		6,000 to 10,000
Bicycle		6,000 to 10,000
Contractors (plumbing, carpentry, electrical, etc.)		10,000 to 30,000
Equipment Rental Service $50,000 to $200,000		
Camping/recreation	$7,500 to $15,000	$15,000 to $25,000
Soft goods (party, sickroom)	12,500 to 21,000	25,000 to 35,000
Fabric store $100,000 to $200,000	25,000 to 35,000	38,000 to 58,000
Hobby/crafts store under $200,000	20,000 to 30,000	36,000 to 56,000

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Estimating Sales Volume

WHAT IS INVOLVED IN ESTIMATING SALES VOLUME?

There are many facto . to consider when estimating sales volume. The volume will depend on the total amount of business i. . area, the number and abil y of competitors now sharing that business, and your own ability compete for the customer's dollar.

One approach to determine your independent estimate is to start with the income you desire. Suppose you hope to earn annual profits of $15,000. Your research rev als that the centage of net profit on sales for the type of business you plan to operate is 4%. Then, to bring an annual return of $15,000, sales of $375,000 ($15,000 ÷ .04) will be required.

In reaching your final estimate of sales, do not be overenthusiastic. A new business generally grows slowly at the start. If you overestimate sales, you are likely to invest too much in equipment and initial inventory and commit yourself to heavier operating expenses than your actual sales volume will justify. You may obtain assistance in making your sales estimate from wholesalers, trade associations, your banker, and other business people. The counsel of others can be compared with your independent estimate of what you believe is needed to make the effort worthwhile to you.

Profit and Loss Statement

WHAT IS THE PROFIT AND LOSS STATEMENT?

The profit and loss statement is a picture of your business that measures costs and expenses against sales and revenues over a period of time. It will show if the business is operating at a profit or at a loss for any given point in time. A profit and loss statement has five components (1) total sales, (2) cost of goods sold, (3) gross profit, (4) expenses, and (5) net profit.

If you haven't yet opened your business, you need to prepare a projected profit and loss statement. The projected profit and loss statement will be one of the financial statements that you include in your business plan. It will help you answer questions asked by a potential lending institution as well as help you make plans for your business. As in determining start-up costs, you can contact friends, relatives, and colleagues who are in a business similar to yours for information. Then you can base your statement on estimated costs, expenses, and sales. When figuring your own profit and loss statement, you should also include monthly estimates. A sample projected profit and loss statement (Exhibit V) is shown on the following page for Jones Gift Shop, a franchised business that operates during the summer months in a resort area. The figures shown are the annual projected sales, costs, and expenses for the months when the business is operated.

Exhibit V
JONES GIFT SHOP
PROJECTED PROFIT AND LOSS STATEMENT

	May	June	July	Aug.	Sept.	Annual
NET SALES						$21,000
COST OF GOODS SOLD						
Beginning Inventory						4,000
Plus Purchases (Freight)						10,000
Minus Ending Inventory						5,000
TOTAL COST OF GOODS SOLD						9,000
GROSS PROFIT						12,000
Less:						
OTHER EXPENSES						
Selling Expenses:						
Salesforce Payroll						2,500
Commissions						- 0 -
Advertising						3,000
Operating Expenses:						
Utilities						900
Rent						3,600
Other						600
TOTAL EXPENSES						10,600
NET PROFIT BEFORE TAXES						1,400

Acquisition Costs

WHAT ARE ACQUISITION COSTS?

The cost involved in obtaining funds, whether from yourself or others, is commonly called acquisition cost. It is the interest or implied interest cost of committing funds to your business. Money is a commodity that can earn interest. Normally, acquisition costs are used in the context of borrowing. However, there is usually a cost involved whether you use your own funds or those of others. The cost involved in investing your own funds is what your money could be earning if it were invested in some place other than your business. Your funds could be earning interest in a savings account or in some other type of investment such as real estate. By investing your funds in the business, you have implied that you can earn more there than by investing them elsewhere.

As an entrepreneur, you should make a projection of your acquisition costs for the first three years of operation. These costs should be calculated to realistically determine the economic justification for going into business. These costs should then be compared with the actual profits generated by the business. By comparing the total acquisition cost of your personal funds and those borrowed with the actual net profit of the business, you can see if you are maximizing your investment. Would you receive a better return on your investment if your funds were invested elsewhere? If so, you will want to review your business very carefully. Your business should at least provide you with a rate of return comparable to a bank's savings account. If you are not making a satisfactory return on your investment, you need to question whether the business ought to continue.

Exhibit W shows what these costs will be for Jones Gift Shop for each of the first three years of operation. The cost of acquisition for Jones Gift Shop is $400 for the first year. If net profit for the first year is $1,400, the business would be providing a greater rate of return than a bank's regular savings account. If the Jones Gift Shop has a net profit of $3,000 for the third year of operation--even though the annual cost of invested funds is only $445--there is a substantial improvement in the rate of return on the investment.

Personal Funds

WHAT SOURCES OF FUNDS ARE AVAILABLE?

The first category of funds listed on the worksheet is personal funds. As the business profits each year, the owner, in effect, will have more personal funds invested in the business, assuming he or she has not withdrawn the profits from the business each year. The interest cost assigned to personal funds in Exhibit W is 5%. This is the approximate rate of interest the funds could be earning if they were in a bank's savings account. Of course, the owner may have chosen to invest these personal funds in real estate, for example, rather than in a savings account.

Exhibit W

JONES GIFT SHOP

SOURCE OF FINANCING WORKSHEET

Sources of Funds	Year 1			Year 2			Year 3		
	Average Outstanding Amount $	Interest %	Annual Cost $	Amount $	Interest %	Annual Cost $	Amount $	Interest %	Annual Cost $
Personal Funds	$6,000	5	$300	$6,900	5	$345	$8,900	5	$445
Outside Sources	1,000	10	100	500	10	50	- 0 -	0	- 0 -
Friends/etc.									
Bank									
Finance Company									
Trade	3,350	0	- 0 -	3,850	0	- 0 -	4,250	0	- 0 -
Other									
Total	$10,350		$400	$11,250		$395	$13,150		$445

Outside Sources

WHAT OUTSIDE SOURCES ARE AVAILABLE?

In Exhibit W outside sources could be funds borrowed from friends, relatives, banks, or other lending sources. In this example, the owner is borrowing fr friends at the rate of 10% per year. By the end f the third year, the owner anticipates paying off this obligation in full.

The "trade" source of funds in the worksheet is the average amount of "accounts payable" the firm has had during the year. It represents the average amount of money owed to suppliers who have sold the owners products and services on credit. The trade figure is the average dollar cost of the items purchased on credit and does not include any interest charges for deferred payments.

Projecting Cash Flow

HOW DO YOU PROJECT CASH FLOW?

"Will I be able to pay the suppliers in time to receive the discount? " "When during the year will contracts be bringing in cash?" To answer these questions, you need to project your cash flow. The cash flow projection gives you a picture of the amount of cash which will come into and go out of your business. If you s n cr , not all sales will produce cash. Also, your firm's income and expenses are not going to be constant each month. Therefore, it is necessary to predict the month-by-month pattern in which cash will actually come in and go out. You can then anticipate, for example, when you will need a loan to cover expenses and begin making arrangements to obtain one early.

Projecting your cash flow will also tell you when there will be a large enough cash balance to be able to invest excess funds.

On the following page is a sample projected cash flow form (Exhibit X). How would you adapt this to fit your business needs? Exhibit Y is a more comprehensive plan for projecting cash flow for twelve months. You can apply this form to the business you want to open.

In summary, determining how much money it will take to open a business requires projecting profit and loss, acquisition costs, an analysis of start-up costs, and a projected cash flow. The more realistic the projections, the better chance the business has to succeed.

GETTING THE NEEDED CAPITAL

HOW DO YOU RAISE THE NECESSARY CAPITAL?

Often, after analyzing financial estimates, the entrepreneur modifies the original plans for financing the business. For example, the entrepreneur may decide that additional capital or funds should be invested to maximize the sales potential. From what sources can this capital be obtained? Where can you get the money to finance your business? There are two general sources. The first source is your own personal funds. The other source requires getting money from others. Most likely you will use a combination of the two.

You should have more of your own personal funds invested in the business than those of outsiders. Financial statements for your new business will probably have to reflect this.

Exhibit X

CASH FLOW PROJECTION

	Jan	Feb	Mar	Apr	May	June
Sources of Cash Cash on hand Cash receipts Sales Accounts receivable payments Loans						
Total Cash						
Cash Paid Out Salary Inventory Sales Tax Overhead Selling expenses						
Total Cash Paid Out						
Cash Balance at End of Month						

Exhibit Y

12-MONTH CASH FLOW

Projections

	Month 1	Month 2	Month 3	Month 4	Month 5	Month 6	Month 7	Month 8	Month 9	Month 10	Month 11	Month 12	TOTAL
CASH (beginning of month)													
Cash on Hand													
Cash in Bank													
Cash in Investments													
Total Cash													
PLUS INCOME (during month)													
Cash Sales													
Credit Sales Payments													
Investment Income													
Loans													
Other Cash Income													
Total Income													
TOTAL CASH AND INCOME													
EXPENSES (during month)													
Inventory or New Material													
Wages (including owner's)													
Taxes													
Equipment Expense													
Overhead													
Selling Expense													
Transportation													
Loan Repayment													
Other Cash Expenses													
TOTAL EXPENSES													
CASH FLOW EXCESS (end of month)													
CASH FLOW CUMULATIVE (monthly)													

Being the greatest investor in the business means that you assume the major risk of the business. To a lender, this shows your commitment. A loan officer may be more willing to partially finance your venture. Having more of your own funds in the business also means you have greater personal control and ownership.

Some individuals enter a business by committing almost all of their own savings and, in so doing, place a restriction on meeting unexpected emergencies. Others want to minimize the risk involved and hesitate to invest a great amount of their personal funds. When projecting the capital funds necessary to start your venture, keep in mind that you will probably be able to borrow an equal amount of what you have personally invested in the business. Regardless of how much you invest of your savings or sale of your investments, you should always hold some cash in reserve in case of emergencies.

There are two types of capital for financing a business: equity and borrowed. Equity capital includes your own personal savings plus the investments of others into your business. Partners, stockholders, Small Business Investment Companies (SBIC's are licensed by the SBA to provide equity capital), Minority Enterprise Investment Companies (MESBIC's), venture capital groups, and local development corporations are some of the sources of equity capital.

Sources for Borrowing Capital

WHAT SOURCES ARE AVAILABLE FOR BORROWING CAPITAL?

There are many sources for borrowing capital. It is more difficult to borrow funds from some sources than from others. Economic conditions, for example, determine the willingness of banks to lend money.

> *Small businessowners...are finding that if they can produce the collateral, banks increasingly are eager to do business with them. Although it is still difficult to obtain venture capital to launch a new business, the established concern is finding more financing avenues for expansion and for dealing with cash shortages.*
>
> *The willingness of many banks to offer s[illegible] business loans is welcome financial relief for many hard-pressed concerns. Inflation has pushed many businesses into higher tax brackets, which means they have reduced retained earnings to spend on expansion. Inflation also means that they have to spend more money on building inventories. In addition, the collection time for accounts receivable has slowed considerably.*
>
> (The Wall Street Journal, November 25, 1977, p. 1)
> Reprinted by permission of The Wall Street Journal
>

In those instances where you are able to use the funds of others, whether it be trade credit, leasing, or borrowing from individuals, make sure you know what the cost of borrowing will be. If you can obtain outside financing at a reasonable cost, by all means do so. Only you can determine what is reasonable.

The easiest and least expensive source of borrowing money is on the cash value of your ordinary life insurance policy. The loan may be obtained directly from the insurance company at a comparatively low interest rate, and, as long as you continue to pay the premiums, the life insurance will remain in force.

Another convenient method of obtaining funds is to use trade credit terms furnished by your supplier. You should examine carefully the terms under which merchandise and other goods are sold to you. If payment is not scheduled according to the usual net terms offered by suppliers of ten or thirty days, then the cost of borrowing these funds (interest expense) may be higher than it would be for funds borrowed directly from a lending institution.

Leasing is a very common business practice. Leasing equipment and building facilities is a popular and convenient way to minimize your cash needs. Leasing can reduce the initial amount of capital required to start the business. Most equipment and building leases are for one to five years. In deciding whether to buy or lease, remember that usually after the terms of the lease expire, you will have nothing to show for your investment.

Borrowing from individuals such as relatives and friends is sometimes difficult to do and does have one underlying disadvantage. The individuals who lend you money may decide they would rather be "active" than "silent" partners. When borrowing from anyone, make sure the terms of the loan are clearly understood by all parties concerned.

When starting a business, it is often difficult to borrow from banks and other lending institutions. Most beginning entrepreneurs are unable to show a past "track record" of doing business and being good credit risks. Until you have proven yourself, a lending institution is going to be hesitant about providing a substantial amount of money to your business. However, once you have begun to operate profitably for two to three years and have demonstrated sound business management, then borrowing from lending institutions will be much easier. Until that time, any loan will probably have to be well-secured in terms of collateral. Borrowing procedures will be discussed further on in this level.

The Small Business Administration (SBA) is a federal agency which loans small businesses more than $2 billion annually. SBA loans are only available to small businesses that have been turned down by two local banks. If a bank will not fund the loan, it will then present the application to SBA to be guaranteed by SBA. The small business may then apply for an SBA direct loan of $150,000 or less. The letter from the bank declining the loan must accompany the application to SBA. The letter must refer to the size of loan requested and include the reasons why the loan was declined. The next section will discuss SBA loans in detail.

Small Business Administration Loans

WHAT ABOUT SBA LOANS?

The following procedures should be followed by applicants seeking SBA loans:

The following information should be taken with you to the bank(s) for review: Ask for a direct bank loan and if declined, ask the bank to make the loan under SBA's Loan Guaranty Plan or to participate with SBA in a loan. If the bank is interested in an SBA guaranty or participation loan, ask the banker to contact SBA for discussion of your application. In most cases of guaranty or participation loans, SBA will deal directly with the bank. If a guaranty or a participation loan is not available, write or call to make an appointment to see one of our Loan Officers. To speed matters make your financial information available when you first write or visit SBA.

A. *A brief description of the business: type, market, operation, start-up date.*

B. *Description of location, with terms of occupancy and copy of lease if applicable.*

C. *Brief personal resume of principals' education, experience and present duties.*

D. *Complete breakdown of use of loan funds and personal injection. Include source of personal investment if not apparent.*

   1. *Full description of all business debt, if any debt is to be covered by the loan.*

   2. *An independent appraisal of assets to be purchased from an existing business or of land and buildings to be purchased.*

   3. *List of machinery and equipment to be purchased, with costs.*

   4. *For new construction, furnish a description of land, detailed description of building, and contractor's cost estimate.*

E. *An existing business must furnish a current balance sheet and the past three years' profit and loss statements. IRS Schedule C's may be substituted for P & L's if necessary. In large or complex operations, audited statements may be required. Applicant must sign all financial statements unless they have been certified by an accountant.*

F. *New business applicants must include a factual (monthly) two year projection or operating forecast. A cash flow chart would be helpful.*

G. *Personal financial statements of principals and all owners of 20% or more of company stock.*

(From unpublished materials distributed at SBA workshops).

The following criteria are set by the SBA to provide loans to certain types of businesses:

AGRICULTURAL:
Considered small if annual gross receipts for the prior year are below $275,000.

MANUFACTURING:
Considered small if total employement is less than 250. Businesses with up to 1,500 employees may also be considered eligible. (Refer to official size standards.)

WHOLESALING:
Considered small if annual sales for preceding year do not exceed %9.5 million. Annual sales up to $22 million may be allowable by size standards.

RETAILING:
Considered small if annual sales fpr preceding year do not exceed $2 million. Annual sales may be up to $7.5 million in certain businesses.

SERVICES:
Considered small if annual sales for preceding year do not exceed $2 million, and up to $8 million depending on the industry by size standards.

CONSTRUCTION:
Considered small if annual sales for the three most recent years do not exceed $9.5 million. Some special trade construction firms carry a maximum of $1 million sales for three prior years' average with alternates up to $2 million.

Although the SBA's basic loan program is well publicized throughout the business community, a good many of the agency's special-purpose loans are barely known beyond government circles. Entrepreneurs in need of government-backed financing should be aware of the following programs:

★ *Economic Opportunity Loans are available to those persons considered to be socially or economically disadvantaged. This program is used most widely for assisting small companies owned by minority-group individuals.*

★ *Displaced Business Loans are available to small firms suffering economic injury as a result of their displacement by, or location near federally-assisted construction projects. Funds are offered for the purpose of relocating or revitalizing injured companies.*

★ *Pool Loans are made to groups of small companies joined together to achieve common objectives. Loan proceeds must be used to obtain raw materials, equipment, inventories, supplies or to contract for research and development. The formation of a pool must be cleared with the Department of Justice.*

★ *Revolving Lines of Credit are financial support arrangements worked out by the SBA with the cooperation of local banks. Under this program small firms engaged in construction or other contract work are granted lines of credit for periods ranging up to 18 months. The SBA guarantees the credit extended by the banks.*

★ *Handicapped Assistance Loans are made to small firms owned by handicapped persons as well as to nonprofit organizations where at least 75 of the worker hours are performed by handicapped individuals.*

★ *Product Disaster Loans may be approved for companies suffering economic injury as a result of diseased food products. To qualify, the companies involved must not be responsible for the diseased conditions.*

★ *Consumer Production Loans are authorized for small firms having to comply with standards set up under the Egg Products Inspection Act of 1970, the Wholesome Poultry and Poultry Products Act of 1968 or the Wholesome Meat Act of 1967.*

★ *Occupational Safety and Health Loans are made to companies suffering economic injury as a result of having to comply with the Occupational Safety and Health Act.*

★ *Base Closing Economic Injury Loans may be authorized to small companies hurt by inadequate supplies of fuel, electrical energy or energy producing resources. The supply problem must be beyond the control of the companies involved.*

(The Columbus Dispatch, June 27, 1976, p. 10)

Lending Institution Procedures

HOW DO YOU OBTAIN A LOAN?

What techniques or procedures must be followed in obtaining funds from a lending institution? The process of applying for a loan is an important step in starting a business. Unfortunately, many people are unaware of the preparation required prior to applying for a loan. Before approaching any lending institution, you should prepare information on and think through the following:

1. *An explanation of the purpose of the loan.* One of the first questions that the loan officer will ask is, "Why are you borrowing?" The purpose of the loan is very important for a variety of reasons including repayment arrangements.
2. *A tentative plan for repayment.* A loan for working capital will most likely be repaid in a different manner than a loan for business equipment. If the loan is for working capital or for a short period of time, then the plan for repayment should reflect the temporary need of the funds. These loans are

usually repaid within three to six months from the date of the loan. If the loan was given to purchase equipment, then the terms of the loan may be for three or even five years.

3. *A "reasonable" rate of interest.* Establishing a rate of interest acceptable to both the lender and the borrower is very important. The rate of interest to be charged should be among the first topics discussed during the loan interview. You should ask about the annual rate of interest as soon as possible.

4. *The history of your business and the nature of its operation.* This includes when it was (or is to be) started, its location, the type of business, how many people are employed, your full-time or part-time commitment to the business, the demand for your service or merchandise, and other beneficial background information. A written statement, or some printed information or brochure which describes your business might be useful. Lenders are always interested in knowing more about your operations, so propose a visit to your current or planned place of business.

5. *A description of principal competitors in your market.* Knowing who your principal competitors are is of vital interest to your banker. Be sure your banker is aware of your knowledge as this will add creditability to your request.

6. *A record of previous loans and bank deposit relationships.* Satisfactory handling of any prior loans will be a plus factor. However, if previous loans have been frequently late or unsatisfactorily paid, then convincing the loan officer to give you the loan will be more difficult. Relationships with banks where you have deposits are also very important. Most banks and other lending institutions will be hesitant to make a loan to you if your deposit accounts are carried elsewhere. Obviously, the first financial institution you should visit to apply for a loan should be the one in which you keep your deposits. If that lending institution is unwilling or unable to make the type of loan you need, then you should promise other institutions you visit that if the loan is made, you will transfer your deposits to them.

7. *A description of the experience and financial soundness of the business owners.* This is probably the most qualitative decision that the loan officer will have to make.
8. *A description of cyclical and seasonal business patterns and their effect on the financing of the business.*
9. *A complete set of recent basic financial statements about yourself and your business.* Statements such as a balance sheet of your net worth or your business's worth; a profit and loss statement, or a projected profit and loss statement for a new business; and a cash flow projection are usually requested.

Lending institutions are interested in how much money you want to borrow, how you'll use it, and how and when you will repay it. Although some believe "lending institutions only lend you money when you don't need it," all they really want is assurance of your ability to repay.

PREPARATION/ADAPTATION ACTIVITIES

Are you able to apply these financing principles to your business aspirations? The following activites should help you check your knowledge of how to finance your business.

ASSESSMENT ONE

Are you a good loan candidate? Rate yourself on a scale from 1 to 10 on the following criteria which apply to business loans.

1. *Business Profile*

   Type of business; major products, how long established? Background, education and experience of business princi-pals. What is legal or organizational structure of firm andy why? Is the business sound? Who are the customers, suppliers and other business connections?

10	5
9	4
8	3
7	2
6	1

2. *Loan Request*

   Is the request well defined and clearly stated? How will the money be used? Can the loan be secured? Is the request? realistic? Is the amount reasonable for the intent?

10	5
9	4
8	3
7	2
6	1

3. *Prospects*

   Is it a growing industry? Does it have good long-term prosects? Does the business have a viable plan? What are the firm's goals? What would happen in the event of an accident or death of owner? What insurance is carried? What is the competition?

10	5
9	4
8	3
7	2
6	1

4. *Financial Condition*

   Does the financial statement show strength? Does the profit and loss statement show profitability? What is the projected cash budget? How does current financial picture compare with previous periods (2-5 years)? How will loan be repaid?

10	5
9	4
8	3
7	2
6	1

5. *Growth Plans*

   What are anticipated sales? How much inventory will be needed? Will there be expense for new facilities or house-hold imporvements? Are more fixtures and equipment required? Are more personnel needed to meet growth demands? What will changes in economy do to the business? How much cash will be needed?

10	5
9	4
8	3
7	2
6	1

6. *Reputation*

What is reputation of the business and the person to whom the loan will be made?	10	5
	9	4
	8	3
	7	2
	6	1

(From unpublished materials distributed at SBA workshops)

POSTASSESSMENT

1. What sources of information can an entrepreneur consult to estimate typical business expenses and sales volume for his or her business?
2. Do start-up costs vary according to the type of business? Are manufacturing businesses the least expensive to open? Why? Why not?
3. Develop a projected profit and loss statement for the business you are considering opening.
4. Prepare a projected cash flow statement for the business you are considering opening.
5. Describe in detail the information you will have to provide to a lending institution that is considering making you a loan. What are other means of obtaining the necessary cash for your business? Which would best suit your needs?

Compare your answers to your responses to the preassessment. You may want to check your postassessment answers with your instructor.

SELF-EVALUATION

How well did you know the information needed to do the activities?

( ) Very well

( ) Fairly well

( ) A little.

Be honest with yourself. If you feel you don't know the material well enough, it might be helpful to review this section before going on.

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FILMS

EXPLORATION LEVEL:

"The Heartbeat of Business" (14 min.) Available for purchase or rental from Sales Branch, National Audiovisual Center--General Services Administration, Washington, DC 20406. Phone (301) 763-1954.

Emphasizes the importance of financial management. Through conversations about and flashbacks of episodes in the main character's business affairs, some examples of good -- and bad -- financial management are dramatized. How to manage business finances and how to practice approved methods are also pointed out.

RESEARCH AND DEVELOPMENT SERIES NO. 194 B-6

PACE

A Program for Acquiring Competence in Entrepreneurship

Instructor's Guide

Part II

Becoming An Entrepreneur

Unit F

How To Finance The Business

THE NATIONAL CENTER
FOR RESEARCH IN VOCATIONAL EDUCATION
THE OHIO STATE UNIVERSITY
1960 KENNY ROAD • COLUMBUS, OHIO 43210

USING THE INSTRUCTOR'S GUIDE

The Instructor's Guide contains the following:

- Teaching/Learning Objectives (identical to the Teaching/Learning Objectives found in the PACE unit)
- Teaching/Learning Delivery Suggestions
- Pre/postassessment Suggested Responses

This information is geared towards the three levels of learning, and is designed for use as a supplemental teaching aid. Additional instructions for using PACE, sources of information, and an annotated glossary can be found in the PACE Resource Guide.

PRE/POSTASSESSMENT
SUGGESTED RESPONSES

EXPOSURE

1. Start-up costs are the one-time costs you will have to meet in establishing your business and the cost of operating the venture until it begins to generate a profit.

2. Net worth is determined by substracting liabilities (what you owe) from assets (what you own).

3. Sources of information include other business owners, government publications, and trade association publications.

4. *Equity financing* is financing the business with your own money or funds provided by others. *Debt financing* is financing the business with borrowed funds.

5. A business plan simply explains what your business venture will be like and describes how you intend to operate it. Plan should include start-up costs, operating expenses, and projected income.

EXPLORATION

1. *Fixed costs* remain fairly constant and include such items as insurance, rent, taxes, and licenses. *Variable costs* change according to volume of production and include such items as salaries, inventory, utilities, advertising, and payroll taxes.

2. To determine the start-up cost for your business you must know what it will cost to establish the firm and operate it until it generates a profit. Responses should indicate knowledge of the various methods of financing.

3. Sources of business loans include life insurance companies, personal finance companies, commercial finance companies, market value of securities or other owned investments, commercial banks, savings and loan associations, Small Business Administration (SBA), and Small Business Investment Companies (SBIC).

4. A *profit and loss statement* shows whether a firm is making a profit or operating at a loss and tells (a) total sales, (b) cost of goods sold, (c) gross profit, (d) expenses (e) net profit. A *projected cash flow statement* illustrates the relationship between incoming and outgoing cash. It indicates when cash is being paid out to debtors and when cash is coming in from sales, investments, etc. The *balance sheet* is a statement of the financial condition on a given day. For example, the statement of start-up costs is an opening day balance sheet.

5. Responses should note the fact that lending institutions do not like to invest a greater percentage of money in a business than the owner has invested. They are reluctant to risk funds that the owner is unwilling to risk.

PREPARATION/ADAPTATION

1. Other business owners, trade associations, government agencies, trade magazines, specialized accounting firms, and colleges and universities are good sources of information.

2. Start-up costs do vary. It costs more to establish manufacturing concerns. Start-up costs must include machinery and equipment expenses, cost of raw materials, and possibly specialized labor costs.

3. Statement should include projected sales, cost of goods sold, expenses, gross profit, and net profit.

4. Statement should project all sources of income and all anticipated debts.

5. Try to prepare as detailed an account as possible. Prepare an explanation of the purpose of the loan, a tentative plan for repayment, a reasonable rate of interest, history of the business and the nature of operations, description of competitors, record of previous loans, and a complete set of recent basic financial statements. Respondents should discuss other sources of obtaining cash such as trade credit, borrowing from individuals, borrowing from their own life insurance policies, and leasing in relation to their planned venture.

	TEACHING/LEARNING OBJECTIVES	TEACHING/LEARNING DELIVERY SUGGESTIONS
	Upon completion of this level of instruction you should be able to:	A variety of different teaching/learning methodologies have been used. To help you organize your work and plan the use of this level these suggestions are made:
Exposure	1. Describe the information needed to determine start-up costs for a business. 2. Explain the difference between equity and debt financing. 3. Describe alternative sources of financing available to small businesses. 4. Describe the information that should be included in a business plan. 5. Describe three financial statements needed for developing a business plan.	1. Invite an officer from a local lending institution to meet with the group and discuss the current situation regarding monies available for small business loans. 2. Invite an entrepreneur who has opened a business within the past year to describe how he or she obtained financing for the business.
Exploration	1. Explain how to determine start-up costs for a business. 2. Identify fixed and variable costs. 3. Explain the difference between equity financing, debt financing, and trade credit. 4. Describe alternative sources for loans. 5. Explain why the business owner will need to invest personal funds in the business. 6. Describe these financial reports: (1) balance sheet, (2) profit and loss statement, and (3) cash flow projection.	1. Invite representatives from a variety of lending institutions for a panel discussion on the availability of money for small business loans, requirements to be satisfied by the applicant to get a loan, and general attitudes of the lending institutions toward issuing loans to small businesses. 2. Contact both the Small Business Administration and a lending institution to obtain information on their lending policies and loan programs. 3. Invite a local CPA or public accountant to meet with the group to discuss the preparation and importance of financial statements.
Preparation/Adaptation	1. Determine capital needs for your business venture. 2. Prepare a projected profit and loss statement and a projected cash flow statement for your business. 3. Describe sources of information available to help you prepare financial reports in your firm. 4. Describe the type of information you will need to obtain a loan.	1. Obtain information on typical business operating ratios from such sources as the *Small Business Reporter* series published by Bank of America and *Annual Statement Studies* published by Robert Morris Associates. 2. Have a local trade credit supplier meet with the group and discuss the firm's policies for dealing with new small businesses.

The PACE series consists of these parts and units.

PART I: GETTING READY TO BECOME AN ENTREPRENEUR

Unit A: Nature of Small Business

Unit B: Are You an Entrepreneur?

Unit C: How to Succeed and How to Fail

PART II: BECOMING AN ENTREPRENEUR

Unit A: Developing the Business Plan

Unit B: Where to Locate the Business

Unit C: Legal Issues and Small Business

Unit D: Government Regulations and Small Business

Unit E: Choosing the Type of Ownership

Unit F: How to Finance the Business

Unit G: Resources for Managerial Assistance

PART III: BEING AN ENTREPRENEUR

Unit A: Managing the Business

Unit B: Financial Management

Unit C: Keeping the Business Records

Unit D: Marketing Management

Unit E: Successful Selling

Unit F: Managing Human Resources

Unit G: Community Relations

Unit H: Business Protection

RESOURCE GUIDE