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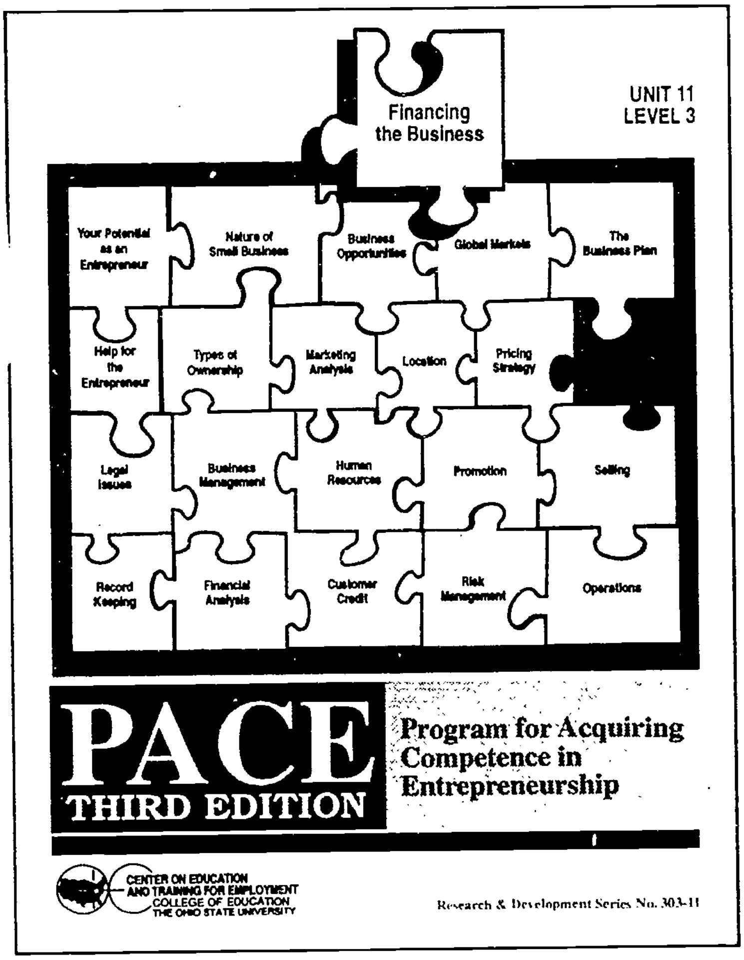
ABSTRACT

This instructor guide for a unit on business finance in the PACE (Program for Acquiring Competence in Entrepreneurship) curriculum includes the full text of the student module and lesson plans, instructional suggestions, and other teacher resources. The competencies that are incorporated into this module are at Level 3 of learning--starting and managing one's own business. Included in the instructor's guide are the following: unit objectives, guidelines for using PACE, lists of teaching suggestions for each unit objective/subobjective, model assessment responses, and overview of the three levels of the PACE program. The following materials are contained in the student's guide: activities to be completed in preparation for the unit, unit objectives, student reading materials, individual and group learning activities, case study, discussion questions, assessment questions, and references. These four objectives are addressed: determine options for financing one's business; discuss the financial information included in a business plan; justify one's financial projections; and explain the use of a loan application package. (YLB)



INSTRUCTOR GUIDE

Unit 11

Financing the Business

Level 3

Objectives:

- Determine options for financing your business.
- Discuss the financial information included in a business plan.
- Justify your financial projections.
- Explain the use of a loan application package.

HOW TO USE PACE

- Use the objectives as a pretest. If a student is able to meet the objectives, ask him or her to read and respond to the assessment questions in the back of the module.
- Duplicate the glossary from the *Resource Guide* to use as a handout.
- Use the teaching outlines provided in the *Instructor Guide* for assistance in focusing your teaching delivery. The left side of each outline page lists objectives with the corresponding headings (margin questions) from the unit. Space is provided for you to add your own suggestions. Try to increase student involvement in as many ways as possible to foster an interactive learning process.
- When your students are ready to do the *Activities*, assist them in selecting those that you feel would be the most beneficial to their growth in entrepreneurship.
- Assess your students on the unit content when they indicate they are ready. You may choose written or verbal assessments according to the situation. Model responses are provided for each module of each unit. While these are suggested responses, others may be equally valid.

Objectives	Teaching Suggestions
1. DETERMINE OPTIONS FOR FINANCING YOUR BUSINESS	
How are the financing needs determined for the business?	Ask students to list sources of information used by entrepreneurs to estimate start-up costs and operating expenses. Using a chalkboard or overhead, show the sources enumerated by your students and add others to complete the list.
What is special about financing a manufacturing business?	Ask students to define the concept of *work-in-process inventory.* Use a simple example to show how accountants compute the work-in-process inventory. Also, define *inventory turnover*.
What is special about financing a service business?	Ask students to explain in their own words how service businesses differ from manufacturing businesses regarding financial analysis.
What is special about financing a franchise business?	First, have students give examples of franchises and explain what characterizes this form of debt financing. Then, use an overhead or chalkboard to list sources of information on franchising.
How do you determine which financing sources to use?	Use the five-step procedure presented in this section to show how financing needs for a small business are determined.
How do you construct a plan of action to satisfy your financing needs?	Use the outline "Checklist for Financing Your Business" presented in this section to discuss the plan of action for satisfying financing needs.

Objectives	Teaching Suggestions
2. DISCUSS THE FINANCIAL INFORMATION INCLUDED IN A BUSINESS PLAN	
What are operating expenses?	Ask students to define the concept of operating expenses and to give examples.
How are operating expense ratios used?	Use Figure 1 in this section to review financial ratio analysis. Make sure students understand the meaning of the ratios and know how to compute them. Use numerical examples to check the knowledge of your students.
How do you determine the financing needed to start your business?	Invite a local entrepreneur to speak about his/her experience regarding methods of estimating financing needs.
What is involved in estimating annual sales volumes?	Refer to the above suggestion. Ask the entrepreneur to use numerical examples like the one presented in Figure 2 to estimate sales volume.
How do you estimate start-up costs and monthly operating expenses?	Use Figure 3 to explain the process of estimating these two important financial components included in the business plan.
How do you determine the total cash needed to start the business?	Refer to the above suggestion.
How do you prepare to arrange the financing?	Engage students in a discussion on how entrepreneurs should prepare financial statements to convince lenders and investors about the worthiness of their business.

Objectives	Teaching Suggestions
How do you prepare a projected income statement?	Follow the step-by-step procedure presented in this section to explain how to develop a projected income statement.
How do you prepare a projected cashflow statement?	Refer to the above suggestion. Make sure students understand the computations in the tables presented in Figures 5 and 6 (i.e., how to compute gross income, net income, pre-operating cashflow, monthly cumulative cashflow, etc.).
How do you prepare your personal balance sheet?	Use this opportunity to ask students to prepare a personal balance sheet. Use the example provided in Figure 7 as a starting point.
3. JUSTIFY YOUR FINANCIAL PROJECTIONS	
Can you justify your financial projections?	Engage students in a discussion on how to justify financial projections in the business plan. Highlight the importance of clearly stating assumptions on sales growth, cost of goods sold, expected cashflow timing, accounts receivable collection, etc.
4. EXPLAIN THE USE OF A LOAN APPLICATION PACKAGE	
How do you prepare a loan application package?	Use the loan application package outline presented in this unit as a ramp toward a more extensive discussion on completing a loan application. Acquaint students with the information contained in such applications. Refer to the Bank One Loan Application Kit presented in this unit.

MODEL ASSESSMENT RESPONSES

1. Available sources of information on estimating financing needs include the SBA Office of Business Development, Dun & Bradstreet, The Bank of America Small Business Reporter, Robert Morris Associates, National Computing Resources Corp., colleges and universities, customers, trade and industry associations, chambers of commerce, Better Business Bureaus, credit bureaus, business sections of libraries, SBDCs, and other government and non-profit organizations.

2. There are five steps involved in determining the financing needed to start a business: (1) estimating annual sales volume, (2) estimating start-up costs, (3) calculating monthly operating expenses, (4) estimating personal living expenses, and (5) determining the total financing needs.

   (1) The estimation of annual sales volume is based on current market conditions in the area and economic conditions, including competition and customer profiles. Projections are based on estimated returns on sales provided by industry associations.

   (2) Start-up costs should be calculated based on investigations of industry operating ratios, your actual best estimates, and the competition's ratios.

   (3) Similar to start-up costs, monthly operating expenses should be estimated based on industry, competition, and your actual estimated ratios.

   (4) The entrepreneur's personal expenses should be carefully considered. The monthly salary should also be accounted for.

   (5) Finally, to determine the financing needed to start the business, monthly operating expenses, start-up costs, and the entrepreneur's personal expenses should be added together. The result should be compared against the entrepreneur's personal savings to estimate the cash that needs to be borrowed.

3. Three steps involved in preparing a projected income statement include: (1) listing the estimated monthly gross sales, (2) listing the cost of goods sold for the monthly projected sales, (3) subtracting the cost of goods sold from estimated gross sales to obtain gross profit, (4) itemizing monthly operating expenses, (5) totaling monthly operating expenses, and (6) subtracting total monthly operating expenses from gross profit to calculate the net profit.

   To prepare a projected cashflow statement, one needs to (1) add together cash-on-hand and loans to determine the total amount of cash available to start the busines., (2) subtract start-up costs from the total amount of cash available to project actual cash left over, (3) itemize sources of cash, (4) add sources of cash, (5) itemize cash disbursements, (6) total cash disbursements, (7) subtract cash disbursements from sources of cash to calculate the monthly cash balance. Monthly cumulative cashflow is computed by adding together the previous month cumulative cashflow and the monthly cashflow balance.

4. To justify financial projections, the entrepreneur needs to clearly state assumptions on sales growth, cost of goods sold, operating expenses, cashflow timing, accounts receivable collection, supplier reliability, and other assumptions that underlie financial projections in the business plan.

5. The five basic parts in a loan application package are: (1) basic application information, (2) loan request, (3) applicant's personal information, (4) business information, and (5) financial projections.

   (1) The basic application information refers to personal data of the applicant and general data on the business, including the type, size, type of ownership of the business, as well as the amount invested in the business by the entrepreneur.

   (2) The loan request section includes the purpose, amount, and terms of the loan, as well as the business's debt to equity ratio, information on collateral, any intended use of borrowed money, etc.

   (3) The applicant's personal information includes the resume, credit references, personal balance sheet, and past two or three years of income tax statements.

(4) The business information section covers the business plan, life and casualty insurance coverage, licenses and permits, lease and agreements, and other information pertaining to the business plan.

(5) The financial projections include projected monthly income and cashflow statements, as well as a first-year projected balance sheet.

PACE

THIRD EDITION

Program for Acquiring Competence in Entrepreneurship

Incorporates the needed competencies for creating and operating a small business at three levels of learning, with experiences and outcomes becoming progressively more advanced.

Level 1 — Understanding the creation and operation of a business.

Level 2 — Planning for a business in your future.

Level 3 — Starting and managing your own business.

Self-contained **Student Modules** include: specific objectives, questions supporting the objectives, complete content in form of answers to the questions, case studies, individual activities, group activities, module assessment references. **Instructor Guides** include the full text of each student module and lesson plans, instructional suggestions, and other resources. **PACE,Third Edition, Resource Guide** includes teaching strategies, references, glossary of terms, and a directory of entrepreneurship assistance organizations.

For information on PACE or to order, contact the Publications Department at the
Center on Education and Training for Employment, 1900 Kenny Road, Columbus, Ohio 43210-1090
(614) 292-4353, (800) 848-4815.

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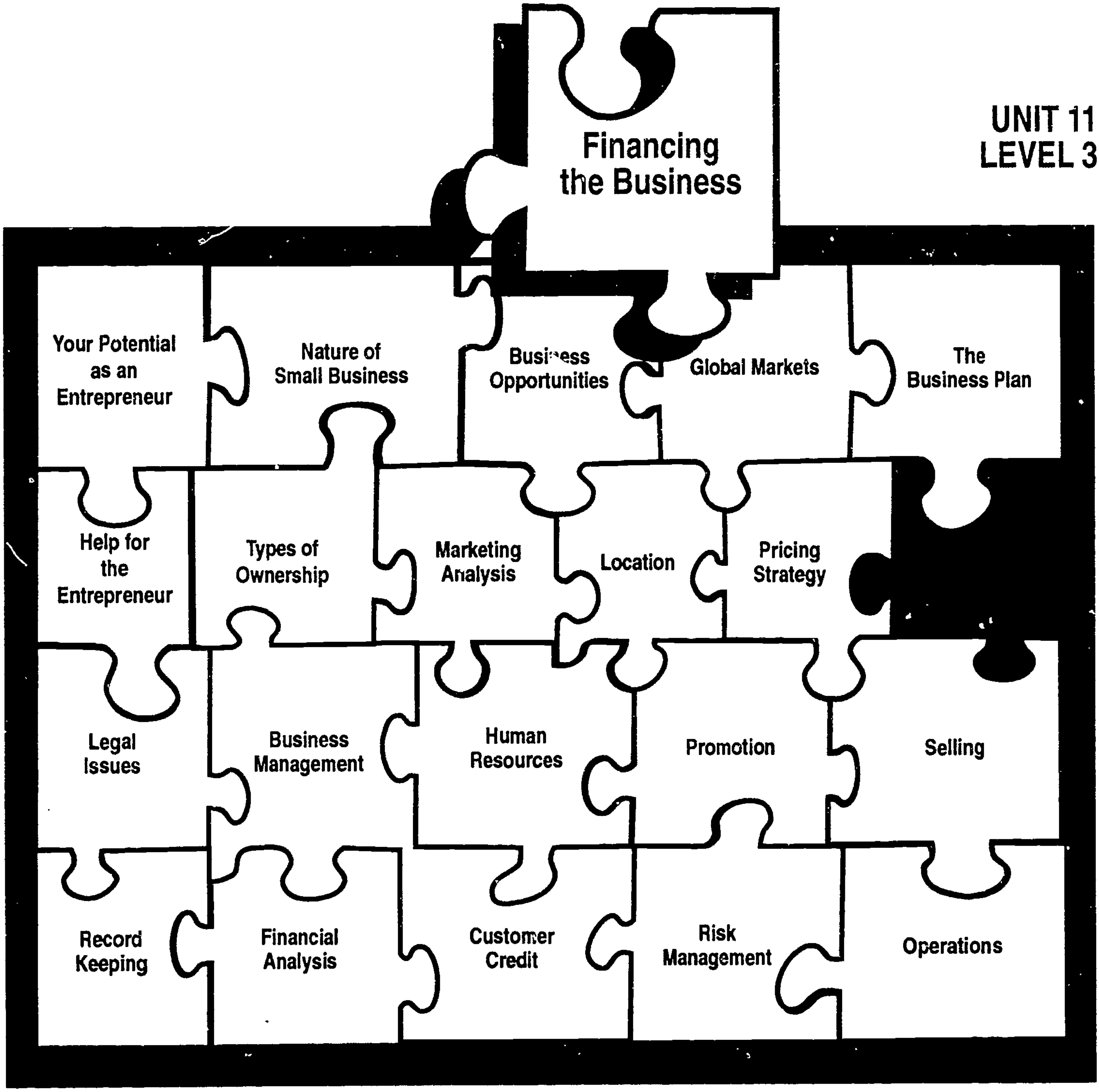
UNIT 11
LEVEL 3



PACE
THIRD EDITION

Program for Acquiring Competence in Entrepreneurship

CENTER ON EDUCATION
AND TRAINING FOR EMPLOYMENT
COLLEGE OF EDUCATION
THE OHIO STATE UNIVERSITY

Research & Development Series No. 303-11

FINANCING THE BUSINESS

BEFORE YOU BEGIN . . .

1. Consult the *Resource Guide* for instructions if this is your first PACE unit.

2. Read What are the Objectives for this Unit on the following page. If you think you can meet these objectives now, consult your instructor.

3. These objectives were met in Level 1 and Level 2:

   Level 1

   - Discuss the personal risks involved in financing a business.
   - Explain the difference between operating expenses and start-up costs.
   - Describe methods of financing a new business.
   - Discuss the importance of having a good credit rating.

   Level 2

   - Discuss the factors to consider in financing a business.
   - Explain how to determine the different types of costs.
   - Compare the advantages and disadvantages of different sources of financing.

4. Look for these business terms as you read this unit. If you need help with the meanings, ask your instructor for a copy of the PACE Glossary contained in the *Resource Guide.*

   Convertible debenture
   Debt-to-equity ratio
   Debt with warrants
   Direct term-loan
   Farmer's Home Administration (FmHA)
   Financial projections
   Flooring
   Indirect collection financing
   Inventory turnover/stock turns
   Policy loan
   Savings and loan association (S&L)
   Stock issue
   Work-in-process inventory

FINANCING THE BUSINESS

WHAT ARE THE OBJECTIVES FOR THIS UNIT?

Upon completion of this unit you will be able to—

- determine options for financing your business,
- discuss the financial information included in a business plan,
- justify your financial projections, and
- explain the use of a loan application package.

WHAT IS THIS UNIT ABOUT?

Financing is the lifeblood of a business. Without capital, a business cannot begin, grow, or ever hope to become successful. Now that you have decided to start a business, here are the two most crucial questions you must ask:

- What are my business's realistic financial needs?
- How do I satisfy these needs?

The information in this unit will help you answer these two extremely important questions. The first part of the unit presents information you can use to investigate and study your business's financial needs. Then you will explain how to prepare estimates of your business's capital needs and the necessary financial statements. After you have examined the preparation and justification of the projected income and cashflow statements, you will study the production and use of the loan application package.

By applying the material presented in this unit, you should be able to determine the amount of the financial lifeblood your business needs and to select the most appropriate sources for supplying it.

HOW ARE THE FINANCING NEEDS DETERMINED FOR THE BUSINESS?

Making a profit is necessary if a business is to succeed. Therefore, carefully investigate the financing needs of your business. 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, retailing, or service—the kind of merchandise or service offered, the income level of your customers, your personal trade connections, the location of your business, and many other factors.

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 this initial investigation than to wait and learn through trial and error. Therefore, secure all the information you need from other people in the same or a similar business, from trade associations, government agencies, libraries, and from other likely sources, such as professional business consultants, accountants, and lawyers. 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:

Small Business Administration
Office of Business Development
Washington, DC 20416
— or call the SBA Small Business Answer Desk 1-800-368-5855. (Ask for Small Business Directory—Publications and Videotapes for Starting and Managing a Successful Small Business.)

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

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

Here are some other organizations or individuals that should be contacted:

- Colleges and universities
- Your own present or potential customers
- Trade associations
- Chambers of commerce
- Better Business Bureaus

- Credit bureaus

- Business sections of libraries

- Small Business Development Centers and related business assistance programs provided by federal, state and local governments or nonprofit groups

The more sources of information that you contact, the more accurate your projection of the financing 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.

WHAT ARE OPERATING EXPENSES?

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 $250,000 to $500,000 might spend 43 percent of its sales on wages and salaries. A bookstore owner in this size range who spends 60 percent of sales in salaries might decide to examine her or his employment policies after finding that the average for similar businesses is 43 percent.

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 and Bradstreet, Inc., trade associations, magazines, specialized accounting firms, publications prepared by industrial companies (for example, "Expenses in Retail Business," by the National Cash Register Co.), and colleges and universities. See Figure 1 for a typical example of the format used by these sources. Next, determine how sales volume can be broken down into the various categories of expenses and profit.

HOW ARE OPERATING RATIOS USED?

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.

As an example of this approach, consider the following hypothetical circumstances. You are planning to open a small retail flower business. Let's suppose that, through the Retail Florists Trade Association, you find that the average flower shop operates on a gross margin of 50 percent, and overhead expenses are 30 percent of sales. The application of this information can help tremendously in determining the amount of overhead expenses and what the cost of the merchandise will be. The *gross margin ratio* or *gross profit ratio* is defined as the percentage of each sales dollar remaining after the

SIC #
YEAR (NUMBER OF ESTABLISHMENTS

	$	%
CASH	______	______
ACCOUNTS RECEIVABLE	______	______
INVENTORY	______	______
OTHER CURRENT	______	______
TOTAL CURRENT	______	______
FIXED ASSETS	______	______
OTHER NON-CURRENT	______	______
TOTAL ASSETS	______	______
ACCOUNTS PAYABLE	______	______
BANK LOANS	______	______
NOTES PAYABLE	______	______
OTHER CURRENT	______	______
TOTAL CURRENT	______	______
OTHER LONG TERM	______	______
DEFERRED CREDITS	______	______
NET WORTH	______	______
TOTAL LIABILITIES AND NET WORTH	______	______
NET SALES	______	______
GROSS PROFIT/MARGIN	______	______
NET PROFIT AFTER TAX	______	______
WORKING CAPITAL	______	______
RATIOS	______	______
LIQUIDITY	______	______
QUICK RATIO	______	______
CURRENT RATIO	______	______
SOLVENCY	______	______
CURRENT LIABILITIES TO NET WORTH	______	______
CURRENT LIABILITIES TO INVENTORY	______	______
TOTAL LIABILITIES TO NET WORTH	______	______
FIXED ASSETS TO NET WORTH	______	______
EFFICIENCY (FUNDS MANAGEMENT)	______	______
COLLECTION PERIOD	______	______
SALES TO INVENTORY	______	______
ASSETS TO SALES	______	______
SALES TO NET WORKING CAPITAL	______	______
ACCOUNTS PAYABLE TO SALES	______	______
PROFITABILITY	______	______
RETURN ON SALES	______	______
RETURN ON ASSETS	______	______
RETURN ON NET WORTH	______	______

Figure 1. Format for obtaining key financial ratios

business has paid for its goods (i.e., the percentage of sales in excess over the cost of sales). Similarly, *gross profit* (or *gross margin*) is the difference between the sales revenue and the cost of sales.

To apply this information you will have to estimate your first year's sales. If you estimate $100,000 in sales your first year, this is what you would find:

\$100,000 in sales x 50% = <u>\$50,000 gross margin</u>

\$100,000 in sales x 30% = <u>\$30,000 in overhead expenses</u>

\$ 50,000 gross margin - \$30,000 in overhead expenses = <u>\$20,000 net profit before taxes</u>

Note that the cost of sales is usually a direct cost incurred by the business. However, the overhead cost is generally considered an indirect cost (we assume that the debt expense is also included in the overhead).

Furthermore, if you found that the average rate of inventory turnover for retail flower shops was 10 times annually, you could also figure the average dollar inventory you would need. Since you estimated your gross margin to be \$50,000 on sales of \$100,000, the cost of the flowers you sold were \$50,000. Now, using the following formula, you can determine the average amount of inventory you need to have on hand.

$$\frac{\text{Cost of merchandise (flowers) sold}}{\text{Average rate of inventory turnover}} = \text{Average Inventory to Have in Stock}$$

$$\frac{\$50{,}000}{10} = \$5{,}000$$

One of the first considerations in financing your business is to determine how much money is needed for inventory, accounts receivable, and, of course, for 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.

In estimating inventory requirements for a wholesale or retail business, talk to 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 business. For example, assume that net sales in your type of business are typically six times the inventory. Then for annual net sales of \$375,000, your inventory should be \$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 over enthusiastic about the amount of merchandise you should stock for your initial inventory.

WHAT IS SPECIAL ABOUT FINANCING A MANUFACTURING BUSINESS?

The procedure for estimating the money needed to start a small factory is similar, but you will need to determine the costs for both production capacity (plant and equipment) and your raw material and *work-in-progress inventory.*

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 percent profit. How many units must be produced to attain this volume?

Assume you plan to manufacture one part that will sell for an average of $20. 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. You are now in a position to determine how much machinery, equipment, and floor space 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 estimates of the costs 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 this case) divided by the expected number of *stock turns* per year. This will provide a rough estimate of the investment you will have to make in acquiring and producing inventory.

WHAT IS SPECIAL ABOUT FINANCING A SERVICE BUSINESS?

Estimating the money needed to start a service establishment will involve a combination of the 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 the business sells labor or machine work, money needed for equipment and wages could be estimated in a similar fashion as for a factory.

WHAT IS SPECIAL ABOUT FINANCING A FRANCHISED BUSINESS?

"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 thousand dollars. Those franchises that require the least startup cash are in the business aids and service areas—areas that are expected to have rapid growth.

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.

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. The sources below, among others, should be consulted prior to making a commitment to work with a franchising company:

- *Franchising Opportunities*, available from International Franchise Association, 1350 New York Avenue, NW, Suite 900, Washington, D.C. 20005

- *Evaluating Franchise Opportunities*, available from SBA Publications, P.O. Box 30, Denver, Colorado 80201-0030

- *Franchising in the Economy*, available from IFA Education Foundation, Inc. and Horwath International, IFA provides current information on trends and statistical comparisons in the franchising business.

Figure 2 illustrates the format utilized by one publication to describe the expected investment, sales, and industry statistics you will need to evaluate in determining the start-up costs and potential viability of a franchise opportunity. These types of statistics are repeated for each industry group and franchising company for several thousand different companies. Some of the service businesses can be started with a relatively small total investment. Tax preparation businesses are a good example. Other businesses, like fast-food restaurants, may require large investments of $300,000 or more.

HOW DO YOU DETERMINE THE FINANCING NEEDED TO START YOUR BUSINESS?

If you have been thorough in your investigation, you should have sufficient information about industry averages, operating ratios, and other general factors affecting the type and amount of financing that your particular type of business requires. It is also advantageous for you to have also talked with bankers, suppliers, competitors, and other knowledgeable people in or related to your industry.

Now is the time to put what you have learned to work. Using the information you have gathered, the next section will assist you in determining your financing needs on a step-by-step basis. The *first step* involves estimating your sales. The *second step* is estimating start-up costs. The *third step* is calculating monthly operating expenses. The *fourth step* is figuring personal living expense requirements. The *fifth step* is adding the start-up, operating, and personal living expenses together to determine the total financing needed to put your business into operation.

WHAT IS INVOLVED IN ESTIMATING ANNUAL SALES VOLUME?

The first step in determining the financing you need is to estimate sales volume for your first year of operation. Your estimated sales volume becomes the target or the goal for all of your expenses in time, effort, and money. Your annual sales goal provides the parameter or means by which you can keep your estimate of financing realistic. There should be a very definite relationship between sales and expenses.

FRANCHISE SALES AND INITIAL COSTS
(in thousands)

Types 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
Convenient 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, Travel	51	15	30
Rental Services (Auto-Truck)	168	40	100
Rental Services (Equipment)	102	10	50
Retailing (Nonfood)	223	25	50
Retailing, Food (Other than Convenient Stores)	152	21	60
Miscellaneous	221	10	38

Figure 2. Median start-up and investment costs for franchises

There are many factors to consider when estimating sales volume. You must estimate the total amount of business in the area, and the number and ability of competitors now sharing that business. Your own ability to compete for the customers' dollars will also impact on sales volume.

One approach to determining your independent estimate is to start with the income you desire. Suppose you hope to earn annual profits of $15,000. Your research reveals that the rate of net profit on sales for the type of business you plan to operate is 4 percent. To bring an annual return of $15,000, a sales of $375,000 ($15,000 divided by 4%) is required. This is a sales goal not a realistic projection. To determine if this level of sales is reasonable, cross check it against several other methods. For example, your industry association may provide average sales per square foot for retail locations. Once you know the size of your store you can compute expected sales for comparison with your goal.

In reaching your final estimate of sales, be cautious. 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 will have to estimate the number of customers and their buying habits by conducting some market research. You may obtain assistance in this research for 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.

HOW DO YOU ESTIMATE START-UP COSTS AND MONTHLY OPERATING EXPENSES?

The investigation you completed of the expense and sales structure of your business should now enable you to make educated estimates of your start-up costs and monthly operating expenses. The worksheet in Figure 3 provides a logical approach for getting your estimates on paper and a means of comparing your figures with industry norms.

The expense and start-up cost worksheet is divided into five columns and a set of category labels describing a listing of the various start-up costs and monthly operating expenses you will have. In each column, you should write in the figures you have discovered or calculated in your investigation.

Column one shows the results of your investigations of industry operating ratios expressed as a percentage of sales. *Column three* is your best estimate of the actual monthly expenses your business will face based upon price quotes, your judgement, business colleagues, and the 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. It will be difficult to develop accurate data from you competition, but it is essential that you conduct the best survey you can to develop your estimates.

Column two is simply calculated by dividing each estimate by monthly sales and expressing the result as a percentage. You can now directly compare the industry-wide operating ratios with your own projected operating ratios. You will need to explain carefully any wide differences between your estimates and the industry norms. For example, if your rent costs are much lower than the industry average, you may wonder if your location is of sufficient quality to support the number of customers you plan to have.

As an illustration, Figure 3 has been completed based upon research indicating sales of $100,000 per year or $8,333/monthly. Assume that this figure is lower than the industry norms for first year sales, but you have elected to accept your own more conservative estimates to avoid planning for higher operating and start-up costs for planned inventory, etc. Your industry sources also have indicated that your sales during the first four months will average several thousand dollars less than the annual average.

As you can see from the example in Figure 3, the prospective owner of the retail flower shop has used the worksheet to determine the money needed to start the business. To be sure there is enough cash on hand to cover monthly operating expenses for three months, the owner will need $9,000. This, added to the $18,775 of start-up costs, shows a total need of $27,775 to get the retail flower shop open and operating.

Entrepreneurs should also remember to consider their personal living expenses when determining the total financing needed to start the business. In some situations, an entrepreneur will have to take money from the business each month to pay for all or part of the personal living expenses. If this is the case, it is critical that the amount needed be known and at least that much is paid to the owner as a salary.

The business owner's living expenses are handled in numerous ways. Sometimes the owner will continue to hold a regular paying job in order to receive a steady paycheck until the new business is large enough to support the entrepreneur. Other times, the income of the owner's spouse is sufficient, and it is not necessary to consider personal living expenses when determining how much cash is needed to get the business going. Then, too, some entrepreneurs will have several months of personal living expenses saved to use until the business has grown enough to take a salary.

The personal living expenses worksheet in Figure 4 is an effective means of determining the entrepreneur's costs of living. With a total figure in mind, the business owner can then calculate how the expenses will be handled. The entrepreneur who started the flower shop did not take a salary. This was to keep monthly operating expenses (and, consequently, the cash needed to start the business) as low as possible. Also, this was practical because the entrepreneur's spouse earned enough income to pay all of their personal living expenses. In the example, personal living expense worksheet illustrates this situation. According to the flower shop entrepreneur, personal living expenses totalled $1,775 per month. The spouse's take home pay was $1,815.

Both of the worksheets discussed here are also available as computer spreadsheets.

	Avg. % of Sales	Your % of Sales	Your Actual $	Your Friend $	Competition $	Average (Friend & Competition)
Start-up Costs						
Purchase of real estate/rent	.0108	.0100	1,000	1,000	1,500	1,250
Decorating/remodeling	.0215	.0150	1,500	2,000	3,000	2,500
Fixtures and equipment	.0603	.0700	7,000	7,500	6,500	7,000
Initial inventory	.0474	.0500	5,000	5,000	6,000	5,500
Accounts receivable	.0065	.0050	500	500	1,000	750
Utility deposits	.0022	.0025	250	250	250	250
Initial advertising	.0013	.0020	200	200	200	150
Office supplies	.0013	.0012	125	125	175	150
Installation of equipment	.0086	.0065	650	750	1,250	1,000
Legal and professional fees	.0151	.0125	1,250	1,500	2,000	1,750
Licenses and permits	.0026	.0030	300	300	300	300
Miscellaneous/Others	.0108	.0100	1,000	1,000	1,500	1,250
Total	.1884	.1877	$18,775	$20,025	$23,675	$21,850
Monthly Operating Expenses						
Salary of owner	.0043	-0-	-0-	-0-	1,000	500
Other salaries	.0056	.0075	750	1,000	300	650
Rent/mortgage	.0037	.0040	400	400	450	425
Advertising	.0006	.0017	175	50	100	75
Delivery expenses	.0009	.0010	100	100	100	100
Supplies	.0019	.0015	150	200	250	225
Telephone	.0009	.0010	100	100	100	100
Utilities	.0028	.0027	275	300	350	325
Insurance	.0019	.0015	150	200	250	225
Taxes	.0019	.0030	300	200	250	225
Loan repayment	.0032	.0040	400	400	350	375
Travel	-0-	-0-	-0-	-0-	50	25
Legal and Professional fees	.0010	.0010	100	100	100	100
Miscellaneous/Others	.0025	.0020	200	250	250	250
Total	.0310	.0360	$3,000	$3,300	$3,900	$3,600

Projected Monthly Sales Income (in thousands)

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
Friend	6	11	7	7	10	8	9	9	10	9	10	10
Competition	7	14	12	10	12	9	9	9	11	11	10	12
Average	6.5	12.5	9.5	8.5	11	8.5	9	9	10.5	10	10	11
Yours	5	10	6	6	9	7	8	9	9	10	10	11

Figure 3. Start-up costs and operating expense worksheet

DETAILED PERSONAL 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)	$ 350
• Car Payments (including insurance)	175
• Appliances/TV Payments	65
• Home Improvement Loan Payments	0
• Personal Loan Payments	35
• Health Plan Payments	55
• Life Insurance Premium	110
• Other Insurance Premiums	50
• Miscellaneous Payments	50
TOTAL	$ 890

Household Operating Expense

• Telephone	60
• Gas and Electricity	140
• Water	25
• Other Household Expenses, Repairs, Maintenance	75
TOTAL	$ 300

Food Expense

• Food-At Home	$ 150
• Food-Away from Home	50
TOTAL	$ 200

Personal Expense

• Clothing, Cleaning, Laundry, Shoe Repair	65
• Drugs	15
• Doctors and Dentists	30
• Education	0
• Dues	0
• Gifts and Contributions	10
• Travel	0
• Newspapers, Magazines, Books	15
• Auto Upkeep, Gas, and Parking	150
• Spending Money, Allowances	100
TOTAL	$ 385

Total Personal Living Expenses	$1,775
Spouse's Net Monthly Pay	$1,815

Figure 4. Personal living expenses worksheet

With the completion of this step (figuring the amount needed to cover personal living expenses), the procedure for determining the total amount of cash needed to start the business is nearly completed.

HOW DO YOU DETERMINE THE TOTAL CASH NEEDED TO START THE BUSINESS?

The fifth and final step simply involves adding the total needed for monthly operating expenses and start-up costs from the second worksheet (Figure 3) with the total needed to pay for personal living expenses (Figure 4). In the flower shop example, the total cash needed was $27,775 since the spouse's income was sufficient to handle all the personal living expenses.

HOW DO YOU PREPARE TO ARRANGE THE FINANCING?

Over the past seven years, the flower shop owner has saved $10,000 to start the business. The question now is where the remaining $17,775 will come from. Since sharing ownership in the business is not desirable, debt financing through some type of loan may be most realistic. With this in mind, the flower shop owner knows that commercial lenders will want financial statements projecting the activity of the business. In addition, a statement reflecting the personal financial position of the entrepreneur is frequently required. If an entrepreneur does not have his or her own personal finances in good condition, lenders will question whether the finances of the business can be handled properly. Therefore, the projected income statement, projected cashflow statement, and personal balance sheet must be prepared.

HOW DO YOU PREPARE A PROJECTED INCOME STATEMENT?

To lend money to a business just being started, most lenders require a projection of the monthly income for the first year. This statement provides an estimate of when the business will begin to make money and how much it will make. This is important to the lender, since loan repayments generally are made from business profits.

The projected income statement is fairly easy to construct if you have used the worksheets previously presented to estimate sales and monthly operating expenses. The following steps make the development of the projected income statement simple.

Step 1. List your estimated gross sales on a monthly basis.

Step 2. List the costs of the merchandise (or service) you estimate will be sold monthly.

Step 3. Subtract the cost of the merchandise (or service) from your estimated gross sales. The resulting figure is your gross margin or profit.

Step 4. Itemize the monthly operating expenses.

Step 5. Total the monthly operating expenses.

Step 6. Subtract the monthly operating expenses from the gross margin or profit. The resulting figure is the net income for the month. Losses are shown by putting parentheses around the number. For example a \$500 loss would be listed as (\$500).

The projected income statement for the retail flower shop is provided in Figure 5. As you can see, the owner is projecting a \$500 loss the first month of operation. Sales are estimated to be much higher during February, the second month, because of Valentine's Day. Therefore, a \$2,000 profit is estimated for the month. The third and fourth months show an equal amount of gross margin or profit and expenses, so there is neither a profit nor a loss, i.e., the business breaks even. A profit is estimated for the remaining months of the first year and, subsequently, a \$14,000 total profit for the first year.

HOW DO YOU PREPARE A PROJECTED CASH FLOW STATEMENT?

Will you 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 cashflow. The cashflow projection gives you a picture of the amount of cash that will come into and go out of your business. If you sell on credit, 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, if you will need a loan to cover expenses and can begin making arrangements to obtain one early.

Like the projected income statement, the projected cashflow statement uses much of the financial information that you have previously calculated. The net income you have projected, plus any additional disbursements or expenditures, are the two major components. The step-by-step procedure for preparing the projected cashflow statement is as follows.

Step 1. Add together any cash on hand and loans you have to determine the total amount of cash you have to start the business.

Step 2. Subtract the start-up costs to project the actual amount of cash left over to start the business. (Steps 1 and 2 were completed in the preoperating column.)

Step 3. For each month of the first year of operation, add the estimated profit or loss that you have previously determined.

Step 4. Determine other cash expenditures or disbursements and list them.

Step 5. Total the disbursements.

Step 6. Subtract the total disbursements from the cash received during each month. This is the net cashflow.

FIRST YEAR

	Jan	Feb	March	April	May	June	July	Aug	Sept	Oct	Nov	Dec	Totals
Gross Sales	5,000	10,000	6,000	6,000	9,000	7,000	8,000	9,000	9,000	10,000	10,000	11,000	10,000
Less Cost of Sales	2,500	5,000	3,000	3,000	4,500	3,500	4,000	4,500	4,500	5,000	5,000	5,500	50,000
Gross Margin or Profit	2,500	5,000	3,000	3,000	4,500	3,500	4,000	4,500	4,500	5,000	5,000	5,500	50,000
Expenses													
Salary of Owner	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Other Salaries	750	750	750	750	750	750	750	750	750	750	750	750	9,000
Rent/Mortgage	400	400	400	400	400	400	400	400	400	400	400	400	4,800
Advertising	75	75	75	75	75	75	75	75	75	75	75	75	900
Delivery	100	100	100	100	100	100	100	100	100	100	100	100	1,200
Supplies	150	150	150	150	150	150	150	150	150	150	150	150	1,800
Telephone	100	100	100	100	100	100	100	100	100	100	100	100	1,200
Utilities	275	275	275	275	275	275	275	275	275	275	275	275	3,300
Insurance	150	150	150	150	150	150	150	150	150	150	150	150	1,800
Taxes	300	300	300	300	300	300	300	300	300	300	300	300	3,600
Loan Repayment	400	400	400	400	400	400	400	400	400	400	400	400	4,800
Travel	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Legal and Pro. Fees	100	100	100	100	100	100	100	100	100	100	100	100	1,200
Miscellaneous/Others	200	200	200	200	200	200	200	200	200	200	200	200	2,400
Total Expenses	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	3,000	36,000
Net Profit or (Loss)	(500)	2,000	-0-	-0-	1,500	500	1,000	1,500	1,500	2,000	2,000	2,500	14,000

Figure 5. Retail flower shop projected income statement for the first year

Step 7. Add the net cashflow to the cumulative cashflow, which is the total amount of cash left over from the previous months. This gives you the total amount of cash you have accumulated.

As an example, the projected cashflow statement for the retail flower shop is presented in Figure 6. The entrepreneur's $10,000 in savings is added to the $17,775 in start-up costs that will be expended in opening the business is subtracted. If you recall, the start-up costs for this business were estimated at $18,775. However, since $500 was for cash and $500 was for accounts receivable, and since these two items were not spent but were actually put into the cash account of the business, they were taken out of the start-up costs disbursement. This left the business with $10,000 in cash to begin operating the business.

Each month the entrepreneur is estimating some additional disbursement beyond monthly operating expenses. In January it is $150. Although these disbursements are not specifically labeled in this example, there should be a specific purpose intended for the money. The $150 in January might be for additional grand opening expenses. The $3,000 in September is to buy a used van for deliveries. Extra holiday personnel may be needed in December, and $1,750 is designated to pay these people. As you can see, it is important to plan your cash disbursements on a monthly basis to determine the impact they will have on your cashflow.

You may have a negative cashflow in some months. This occurs when you spend more cash than you take in during the month. You will notice this is the case in January, March, April, and September. This is feasible for the flower shop owner because there will be sufficient cash accumulated to make up the difference. If this were not the case, some type of loan or credit arrangement might be necessary.

HOW CAN YOU JUSTIFY YOUR FINANCIAL PROJECTIONS?

Projections are based upon uncertain assumptions about the future. You will need to prepare for the arguments that will be raised against your proposals by those you approach for financing. The best counter argument is to include answers to the basic questions in your original presentation. Remember, lenders or investors are primarily interested in assuring that they are repaid. Four types of answers should be included within your financial plan as follows:

1. Provide clearly stated assumptions upon which you base your projections of—
   - sales,
   - cost of goods sold,
   - expenses,
   - cashflow timing,
   - accounts receivable collections, and
   - supplier reliability.

FIRST YEAR

	Pre-operating	Jan	Feb	March	April	May	June	July	August	Sept	Oct	Nov	Dec
Sources of Cash													
Cash on Hand	$10,000												
Loan	17,775												
*Net Profit		(500)	2,000	-0-	-0-	1,500	500	1,000	1,500	1,500	2,000	2,000	2,500
Total	27,775	(500)	2,000	-0-	-0-	1,500	500	1,000	1,500	1,500	2,000	2,000	2,500
Disbursements													
Start-up Costs Owner's Draw	17,775												
Income Tax					1,500								
Others (beyond monthly operating expenses)		150	200	100	100	300	100	200	300	3,000	300	300	1,750
Total	17,775	150	200	100	1,600	300	100	200	300	3,000	300	300	1,750
Net Cash Flow	10,000	(650)	1,800	(100)	(1,600)	1,200	400	800	1,200	(1,500)	1,700	1,700	750
Cumulative Cash Flow	10,000	9,350	11,150	11,050	9,450	10,650	11,050	11,850	13,050	11,550	13,250	14,950	15,700

Figure 6. Retail flower shop projected cashflow for the first year

*Net profit is carried over from the projected profit-and-loss statement.

2. Provide complete documentation which explains how you developed each cost estimate or projection. For example,

   - copies of quotes from suppliers,

   - references to specific industry operating ratio reports, and/or

   - results of surveys you have made of customers and competitors.

3. Provide a realistic discussion of the "downside" risks of the proposed business. Frankly discuss those areas where you are not sure exactly what will happen during the projection period.

   For each risk that you identify, develop an alternative plan that will allow the business to keep operating (and repaying any loans.)

4. Develop a clear, concise discussion of the "safety" margin you have built in to your projections. Use the lowest sales and highest cost estimates. Use "conservative" assumptions in preparing your projections.

When your plan is "justified" to your satisfaction, you should present it to a business advisor or counselor who has no financial or other stake in your business. Small Business Development Center or SCORE counselors are excellent at providing an objective second opinion and critique of your plan. It is critical that you experience this type of criticism prior to presenting the plan to an investor or lender. You can expect to receive strong criticism on your first efforts—later versions will be much better justified and realistic in the eyes of potential lenders.

HOW DO YOU PREPARE YOUR PERSONAL BALANCE SHEETS?

Your personal balance sheet provides any potential lender with an overall view of your financial position. A sufficiently large net worth, will make you more appealing as a loan applicant. An entrepreneur with a weak financial position and a large number of debts may not meet the standards of the lenders.

The personal balance sheet includes a summary of your assets, what you own that has cash value, and your liabilities or debts. The example in Figure 7 is of an entrepreneur starting the flower shop.

Preparing your personal balance sheet involves a few simple steps.

Step 1. Determine the value of all your assets. These would be the items you own that have cash value. List them on the balance sheet.

Step 2. Total the value of your assets.

Step 3. List all of your debts.

Step 4. Total the amount of your debts and liabilities.

Step 5. Deduct your total liabilities from your total assets. This is your net worth.

ASSETS: Everything you own with cash value.		
Cash money you have on hand and in the bank		$ 975.00
Savings account		$10,000.00
Stocks, bonds, other securities		$
Accounts/notes receivable		$
	$ 2,319.00	
Rebates/refunds		$
Autos/other vehicles		$ 6,342.00
Real estate		$62,500.00
Vested pension plan/retirement accounts		$
Other assets (furnishings, appliances, jewelry, furs, cameras, tools, pets, trusts, etc.)		$ 5,417.00
TOTAL ASSETS		$87,373.00
LIABILITIES: What you owe; your debts		
Accounts payable		$ 350.00
Contracts payable		$ 1,150.00
Notes payable		$
Taxes		$ 2,485.00
Real estate loans		$35,475.00
Other liabilities (court-demanded payments, etc.)		$
TOTAL LIABILITIES		$39,460.00
TOTAL ASSETS	$87,373.00	
LESS TOTAL LIABILITIES	$39,460.00	
NET WORTH		$47,913.00

Figure 7. Personal balance sheet for retail flower shop owner

SOURCE: Reprinted with permission from Bank of American NT&SA, "Steps to Starting a Business," Vol. 10, No. 10, *Small Business Reporter.*

The financial position of the entrepreneur starting the flower business is solid. The assets include cash, personal savings, life insurance, an automobile, real estate, and personal property. The liabilities are fairly limited, with the biggest loan being the mortgage on the real estate. There is about \$2.22 worth of assets for every \$1.00 of liability. It is evident that the entrepreneur has handled his or her personal financial affairs well. This will certainly help impress a commercial or government lender, and should help obtain the necessary debt financing to get the flower shop started.

HOW DO YOU DETERMINE WHICH FINANCING SOURCES TO USE?

With the financial statements prepared, you are now ready to zero in on the specific financing sources you wish to use. The mix of sources that the entrepreneur will eventually use is based upon the interaction of several variables. Some of these variables are as follows:

- The amount and timing of the money needed
- Current economic conditions and prevailing interest rates
- The credit record of the entrepreneur
- The specific purpose that the financing will be used for
- The type of business being started and its prospect for success

An aspiring entrepreneur should study the situation carefully. It may be wise to discuss the matter with your local banker, SBA office, or Small Business Development Center consultant. The Small Business Financing Guide presented in Figure 8 may be helpful, as well.

SMALL BUSINESS FINANCING GUIDE

Use of Funds	Type of Money	Source	Financing Vehicle
Business	Equity	Nonprofessional investor	Partnership formation Stock issue
		Venture capitalist SBIC-MESBIC	Stock issue Convertible debentures Debt with warrants
	Long-term debt	Bank	Term loan (limited) Unsecured term loan Equipment loan Equipment leasing Real estate loan
		SBIC-MESBIC	Term loan (limited) Unsecured term loan Equipment loan Equipment leasing
		Commercial finance company	Equipment loan Equipment leasing Real estate loan
		Life insurance company	Policy loan Real estate loan
		Savings and loan association	Real estate loan
		Leasing company	Equipment leasing
		Consumer finance company	Personal property term loan
		Smal! Business Administration Ec. Development Administration	Term loan guarantee Direct-term loan (limited)
		Local development company	Facilities/equipment financing
		Farmers Home Administration	Term loan guarantee
Working Capital	Long-term debt	Bank	Unsecured term loan Equipment loan Real estate loan
		Commercial finance company	Equipment loan Real estate loan
		Life insurance company	Policy loan Real estate loan Unsecured term loan (limited)
		Savings and loan association	Real estate loan
		Consumer finance company	Personal property loan

Use of Funds	Type of Money	Source	Financing Vehicle
		Small Business Administration Economic Development Administration SBIC-MESBIC	Term loan guarantee Direct-term loan (limited)
		Farmers Home Administration	Term loan guarantee
Seasonal Peak	Short-term debt and Line of Credit	Supplier	Trade credit
		Life insurance company	Policy loan Unsecured loan (limited) Real estate loan
		Commercial finance company	Accounts receivable financing Inventory financing Factoring
		Factor	Factoring
		Life insurance company	Policy loan
		Consumer finance company	Personal property loan
		Small Business Administration	Line of credit guarantee (limited)
Equipment Facilities Acquisition	Long-term debt	SBIC-MESBIC	Term loan
		Bank Commercial finance company	Equipment loan Equipment leasing Real estate loan
		Savings and Loan association	Real estate loan
		Consumer finance company	Personal property term loan
		Leasing company	Equipment leasing
		Small Business Administration	Term loan guarantee
		Economic Development Association	Direct-term loan (limited)
		Local development company	Facilities/equipment financing
		Farmers Home Administration	Term loan guarantee
		Nonprofessional investor	Partnership formation Stock issue

Use of Funds	Type of Money	Source	Financing Vehicle
		Venture capitalist	Stock issue Convertible debentures Debt with warrants
		SBIC-MESBIC	Term loan
		Bank	Unsecured term loan Equipment loan Equipment leasing Real estate loan
		Commercial finance company	Equipment leasing Real estate loan
		Life insurance company	Unsecured term loan Policy loan Real estate loan
		Savings and loan association	Real estate loan
		Consumer finance company	Personal property loan
		Leasing company	Equipment leasing
		Small Business Administration Economic Development Administration	Term loan guarantee Direct-term loan (limited)
		Local development company	Facilities/equipment financing
		Farmers Home Administration	Term loan guarantee
	Line of credit	Supplier	Trade credit
		Bank	Unsecured loan of credit Accounts receivable financing Inventory financing Flooring Indirect collection financing
		Commercial finance company	Accounts receivable financing Inventory financing Factoring
		Factor	Factoring
		Small Business Administration	Line of credit guarantee (Limited)

Figure 8. Small Business Financing Guide

HOW DO YOU PREPARE A LOAN APPLICATION PACKAGE?

The choice of financing sources you qualify for and decide to use will essentially dictate the contents of your loan application package. Whereas some lenders may request a very detailed presentation, others—who may already know you—may ask for less information.

The breadth, depth, and quality of your loan application package will dramatically affect your chances for approval. It is vital to put together a package that presents you, your ideas, and your business plan in an impressive manner.

The following is an outline of a business loan application package.

Loan Application Package Outline

I. Basic Application Information

   A. Applicant's name, address, and telephone number
   B. Business name, address, and telephone number
   C. Type of business
   D. Size of business
   E. Type of ownership
   F. Applicant's financial contribution to business

II. Loan Request

   A. Purpose of loan
   B. Amount
   C. Terms, including desired interest rate
   D. Debt/equity ratio
   E. Collateral
   F. Specific use of money borrowed

III. Applicant's Personal Information

   A. Resume, including education, work experience, and business background.
   B. Credit references
   C. Personal balance sheet
   D. Past two to three years' income tax statements

IV. Business Information

   A. Business plan
   B. Life and casualty insurance coverage
   C. Business licenses or permits
   D. Lease/facilities agreement
   E. Other supporting information

V. Financial Projections

   A. Projected monthly income statement for at least one year
   B. Projected cashflow statement for at least one year
   C. Some lenders may also ask for a projected balance sheet for the first year

The above outline should help you understand what kind of information lenders require to approve loans. Loan application packages should be filled out by entrepreneurs in a most logical and accurate way possible. It is this package, along with the business plan that convinces the banker or other lenders to offer a loan.

To better acquaint yourself and understand the requirements of a loan application, refer to the Bank One Business Loan Kit preceding the Activity section.

HOW DO YOU CONSTRUCT A PLAN OF ACTION TO SATISFY YOUR FINANCING NEEDS?

Determining and satisfying the financing needs of your business takes a great deal of thought, planning, and organizing. You need to develop and execute a complete plan of action. The following Checklist for Financing Your Business should help you as you devise your plan. The checklist items are organized by the steps you need to take to arrange your financing. To determine whether you are being thorough in completing the financial steps, ask yourself each question on the checklist. If you have completed the activity, put a check mark (√) beside the item. If you answer no to the question, leave the line blank. Then, ask yourself if the item is applicable to your situation. If it is, you should plan to complete the activity. If it is not, put N/A beside the question and go on to the next item. After completing all the checklist items, your financing plan should be ready to go.

Checklist for Financing your Business

Step 1. Investigate Your Financial Needs

- Have you obtained specific information on operating ratios and start-up costs from trade associations, the SBA, financial service companies, and other sources?
- Have you talked with others, including competitors in your field?
- Have you talked with your banker, suppliers, and other knowledgeable sources about your financing needs?
- Have you determined what is unique about financing your particular type of business?

Step 2. Determine the Type and Amount of Financing You Need

- Have you used the information gathered in your investigation?
- Have you used operating ratios to estimate your financial needs?
- Have you used actual quotations of prices for inventory and equipment needs?
- Have you estimated your sales volume for the first year?
- Have you determined what type of start-up costs and monthly operating expenses you will have?
- Have you completed Start-up Costs and Operating Expenses Work sheet (Figure 3)?
- Have you determined where the money will come from to cover your personal living expenses while you start the business?

- Have you used the Personal Living Expense Work sheet (Figure 4) to determine your monthly personal budget?

Step 3. Prepare to Arrange the Financing You Need

- Have you determined how much you are personally going to invest in the business?

- Have you determined how much additional financing you are going to need, beyond your personal investment, to get the business started?

- Have you prepared a projected income statement (Figure 5)?

- Have you prepared a projected cashflow statement (Figure 6)?

- Have you prepared a personal balance sheet (Figure 7)?

- Have you received a "second opinion" from an objective professional business advisor or counselor?

Step 4. Determine which Financing to Use

- Have you considered the advantages and disadvantages of the equity financing alternatives?

- Have you considered the advantages and disadvantages of the debt financing alternatives?

- Have you considered which sources of financing you qualify for?

- Have you determined the type and form of financing that best suits the needs of your business?

- Have you determined the priority for approaching and using your potential financing sources?

Step 5. Prepare the Loan Application Package

- Have you discussed loan application procedures with potential lenders?

- Have you determined the information required for the loan application package?

- Have you determined what collateral you will use?

- Have you gathered and organized the information needed for your loan application package?

- Have you completed your loan application package and had it reviewed and checked by another person?

Step 6. Present the Loan Application Package and Negotiate the Financing Needed to Start Your Business

Securing financing for your business is only the beginning. But, solid financing is essential for a **good** beginning. The process can be complicated, and at times a little overwhelming. Therefore, make sure you are well-advised and choose carefully.

BUSINESS LOAN KIT

BANK ONE*

*All Bank One materials are used with permission.

Dear Applicant:

THANK YOU FOR CONSIDERING BANK ONE for your business financial needs. We put together this business loan kit to help you get started in developing your company's overall business strategy.

SECTION I of the Business Loan Kit is the business plan. For the start-up business, we have prepared a series of questions that will assist you in developing clear and precise business objectives. The answers to these questions will help you to complete the next step—the actual business plan and projections. If you have already established a business plan, you may want to review this section to ensure that your present plan has addressed all pertinent areas.

SECTION II of the Business Loan Kit is the actual loan application. This should be completed once you have developed your business plan. You will find that much of this information is needed to complete the loan application form. Please be sure to complete the entire application before submitting it to your Business Banking Group Officer. In addition, we have enclosed a glossary of terms that may be helpful to you when completing the business plan and application.

We thank you again for considering BANK ONE, and we look forward to hearing from you soon.

Sincerely,

Business Banking Group Officers

Section I

THE BUSINESS PLAN

The business plan is a management tool. When developed and used properly, it is one of the most effective communication tools used to obtain financing for your business. It also can assist the business owner in achieving his/her goals. The business plan is a road map whereby the business owner measures his/her goals. The business plan should reflect the business owner's own ideas clearly and succinctly.

Before you start developing your business plan you should ask yourself the following questions:

1. Are you the kind of person who can get a business started and run it successfully?
2. Does your family go along with your plan to start a business of your own?
3. Have you worked in a business similar to the one you want to start?
4. Have you had any business training in school?
5. Do you know how much money you will need to get your business started?
6. Have you determined how much of your own money you can put into the business?
7. How much personal income do you require and could this be reduced if necessary?
8. Have you decided on a marketing plan?
9. Have you talked with other business owners in the area about what they think of the business?
10. Can you determine what you should charge for each product or service you sell?
11. Have you tried to find out how well businesses similar to the one you want to open are doing in your community and in the rest of the country?
12. If you need to hire someone to help you, do you know where to look?
13. Do you know what benefits to provide?
14. Do you have a plan for training your employees?
15. Have you talked with the company's potential suppliers?
16. Have you decided whether to let your customers buy on credit?
17. Have you talked with an insurance agent about what kind of insurance you need?
18. Do you know what equipment and supplies you will need and how much they will cost?
19. Can you save money by buying secondhand equipment?
20. Have you compared the prices and credit terms of different suppliers?

Business Plan Outline

The previous questions should help you in developing your business plan. Once you have formulated your answers, you should begin developing your business plan. The following is an outline to be used in developing your business plan.

I. **Cover Letter**
   A. Dollar amount requested
   B. Terms and timing
   C. Type and amount of collateral
   D. Purpose and source of repayment

II. **Summary**
   A. Business description
      1. *Name*
      2. *Location and plant description*
      3. *Product*
      4. *Market and competition*
      5. *Management and business goals*
   B. Summary of financial needs and application of funds

III. **Products or Services**
   A. Description of product line
   B. Proprietary position: patents, copyrights, legal and technical consideration
   C. Product comparison

IV. **Manufacturing Process (if applicable)**
   A. Materials
   B. Source of supply
   C. Production methods

V. **Market Analysis**
   A. Description of total market
   B. Industry trends
   C. Target market
   D. Competition

VI. **Marketing Strategy**
   A. Overall strategy
   B. Pricing policy
   C. Methods of selling, distributing, and servicing

VII. **Management Plan**
   A. Form of business organization
   B. Board of Directors (Owner or Partners)
   C. Officers: organization chart and responsibilities
   D. Resumes of key personnel
   E. Staffing plan/number of employees
   F. Facilities plan/planned capital improvements
   G. Operating plan/schedule of work for next 1-2 years

VIII. **Financial Data**
   A. Financial statements (three years to present)
   B. Three-year financial projections (first year by months, remaining years annually)
      1. *Profit and loss statements*
      2. *Cash Flow charts*
      3. *Balance sheets*
   C. Explanation of projections
   D. Explanation of use and impact of new funds

Projections

When preparing projected financial statements for your business plan you must start with basic assumptions for income and expenses. These assumptions for income and expenses should be detailed in your business plan with supporting documentation derived from the market study and the market strategy in the business plan. The projected financial statements should indicate economic changes in your business cycle. For instance, if your business is seasonal, sales during a specific period will be greater than another period. Your financial projects should indicate the fluctuation in sales and expenses.

There are three types of financial statements:

- **Profit/Loss Statement**

The profit/loss statement will take your income minus expenses and equal either a profit or a loss.

For the first year the projected profit/loss statement should be done on a monthly basis. Thereafter, the second and third year may be done on a quarterly basis.

- **Cash Flow Statement**

The projected cash flow statements will show the cash generated and collected from the business operations. This statement will utilize the same income and expense as the profit/loss statement, however, it takes last month/quarter previous cash and adds that into total cash/ receipts for the new month/quarter. Timing differences resulting from accounts receivable turnover and the ongoing need for cash to fund expenses will indicate your business need for working capital.

- **Balance Sheet**

The balance sheet records the total assets, liabilities, and equity of a business on a specific day.

The projected balance sheet is done every twelve months. If your company's business year end is December 31, then your proforma balance sheet reflects the assets, liabilities, and equity on that date. The projected balance sheet should reconcile with the projected profit/ loss and cash flow statements.

Included in this kit are forms to be used in the financial forecasting of your business. A rule of thumb when forecasting; "be as conservative and as realistic as possible." Remember, your business plan should provide you with all the supporting documentation when forecasting.

PROJECTED PROFIT AND LOSS STATEMENT

	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
Total Net Sales													
Cost of Sales													
GROSS PROFIT													
Controllable Expenses Salaries													
Payroll Taxes													
Security													
Advertising													
Automobile													
Dues and Subscriptions													
Legal and Accounting													
Office Supplies													
Telephone													
Utilities													
Miscellaneous													
Total Controllable Expenses													
Fixed Expenses Depreciation													
Insurance													
Rent													
Taxes and Licenses													
Interest payments on loans													
Total Fixed Expenses													
TOTAL EXPENSES													
NET PROFIT (LOSS) before taxes													

CASH FLOW PROJECTIONS

	Start Up or Prior to Loan	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														
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														
Other cash expenses														
TOTAL EXPENSES														
CASH FLOW +/- (end of month)														
LOANS MONTHLY Short-Term Loan														
MONTHLY Long-Term Loan														
ENDING CASH														
TOTAL Short-Term Loan														
TOTAL Long-Term Loan														

Balance Sheet Spread Sheet For:

as of , 19XX

	19__	19__	19__	TRENDS
Assets				
Cash				
Accounts Receivable—Trade				
Inventory				
Other—A/R Officer				
Other				
Other				
TOTAL CURRENT ASSETS				
Leasehold Improvements				
Vehicles				
Furniture/Fixtures/Office Equipment				
Equipment				
Buildings				
Land				
Accumulated Depreciated	( )	( )	( )	
FIXED ASSETS (NET)				
Other—Patent Acquisition				
TOTAL ASSETS				
Liabilities and Net Worth				
Notes Payable—Bank				
Current Portion—L-T Debt				
Accounts Payable—Trade				
Accruals				
Other				
Other				
TOTAL CURRENT LIABILITIES				
Long Term Debt				
Mortgages				
Other				
TOTAL LONG TERM LIABILITIES				
TOTAL LIABILITIES				
Capital Stock				
Additional Paid-In Capital				
Retained Earnings				
NET WORTH				
TOTAL LIABILITIES AND NET WORTH				

Section II

BUSINESS LOAN APPLICATION

I. Application Company/User

Name of Company/User of Funds

Federal Tax Identification Number

Business Legal Structure

Company's Fiscal Year End Date

Year Business Began

Name of Borrower (if different from user)

Relationship of Borrower to Company/User

Street Address of Company

City | State | Zip

Contact Person | Title

Telephone

II. Principal Officers

(20% or more ownership)

Name and Title

% Ownership | SS#

Name and Title

% Ownership | SS#

III. Information on Existing Business

(If start-up business, please complete Section I)

Type of Business

Principal Product/Service

IV. Purpose of the Loan

(Briefly describe Proposed Project)

(continued on next page)

If loan involved acquisition of real estate, please complete the following:

Location ______ Address ______

City/Village/Township ______ County ______

V. Project Cost/ Use of Funds

Land $ ______

Building $ ______

New Construction $ ______

Acquisition $ ______

Renovation $ ______

Equipment

______ $ ______
Type of Equipment

______ $ ______
Type of Equipment

______ $ ______
Type of Equipment

______ $ ______
Other

Other Financing Needs

Account Receivables $ ______

Inventory $ ______

Account Payables $ ______

Other—Explain $ ______

______ $ ______

Total Project Cost $ ______

VI. Historical Financial Information

	19__	19__	19__	Interim Month 19__
Current Assets				
Total Assets				
Current Liabilities				
Net Worth				
Annual Sales				
Depreciation				
Earnings Before Tax				
Profit After Tax				

VII. Please provide BANK ONE with the following information:

1. *Three years Historical Financial Statements (Balance Sheet, Profit/Loss)
2. One year Proforma Financial Statements (Balance Sheet, Profit/Loss, Cash Flow)
3. Interim Financial Statements (not more than 90 days old)
4. Accounts Receivables Aging and Accounts Payable Aging
5. Personal Financial Statements and Federal Income Tax Returns (Required for all business owners with 20% or more ownership)
6. Brief history of Existing Business
7. Specifics of Loan Request—Purpose, Amount, Source of Repayment
8. Lease Agreement
9. Purchase Agreement
10. Articles of Incorporation/Partnership Agreement
11. Evidence of Hazard Insurance
12. Trade Reference (3 customers, 3 suppliers)
13. Name of Accountant
14. Name of Attorney

*Financial Statements prepared by CPA are preferred, however, direct statements prepared in-house can be submitted along with Federal Tax Returns.

Are taxes current? ☐ yes ☐ no

If the answer is "no" how much is delinquent? $ ____________

Which taxes are delinquent? ☐ Federal Taxes ☐ FICA ☐ State ☐ City

BANK ONE reserves the right to request additional information from the company.

As an authorized agent of the applicant company, I have stated that everything in the application and information submitted along with the application is true. BANK ONE is authorized to check trade and credit references as well as personal credit history in processing the loan application.

______________________ ______________________ ______________________
Signature Title Date

Personal Financial Statement

IMPORTANT: Read these directions before completing this Statement

- [ ] If you are applying for individual credit in your own name and are relying on your own income, or assets and not the income or assets of another person as the basis for repayment of the credit requested, complete only Sections 1, 3, and 4.
- [ ] If you are applying for joint credit with another person, complete all Sections and provide information in Section 2 about the joint applicant. If appropriate, the joint applicant may complete a separate personal financial statement, and the applications may be submitted together.
- [ ] If you are applying for individual credit but are relying on income from alimony, child support, or separate maintenance or on the income or assets of another person as a basis for repayment of the credit requested, complete all Sections. Provide information in Section 2 about the person whose alimony, support, or maintenance payments or income or assets you are relying on. Alimony, child support, or separate maintenance income, need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.
- [ ] If this statement relates to your guaranty of the indebtedness of other person(s), firm(s), or corporation(s), complete all Sections.

SECTION 1 — INDIVIDUAL INFORMATION (TYPE OR PRINT)		SECTION 2 — OTHER PARTY INFORMATION (TYPE OR PRINT)	
Name		Name	
Address		Address	
City, state & zip		City, state & zip	
Position and occupation		Position and occupation	
Business name		Business name	
Business address		Business address	
City, state & zip		City, state & zip	
Length of employment		Length of employment	
Res. phone	Bus. phone	Res. phone	Bus. phone

Please do not leave any questions unanswered. Use "no" or "none" where necessary.

SECTION 3 — STATEMENT OF FINANCIAL CONDITION AS OF ______ 19__

ASSETS (Do not include assets of doubtful value)	In Dollars (Omit cents)	LIABILITIES	In Dollars (Omit cents)
Cash on hand and in this bank — see Schedule A	$	Notes payable to banks — see Schedule G	$
Cash in other banks, savings & loans, etc. — see Schedule A		Notes payable to other institutions — see Schedule G	
U.S. Gov't. & Marketable Securities — see Schedule B		Notes payable to individuals and others — see Schedule G	
Non-Marketable Securities — see Schedule C		Due to brokers	
Securities held by broker in margin accounts		Accounts and bills due	
Restricted or control stocks		Unpaid income tax	
Real estate owned — see Schedule D		Other unpaid taxes and interest	
Accounts, loans and other notes receivable		Real estate mortgages payable — see Schedule D	
Automobiles and other vehicles		Life insurance loans — see Schedule E	
Other personal property		Other debts — itemize	
Cash value — life insurance — see Schedule E			
Book value of business ventures — see Schedule F			
Other assets — itemize			
		TOTAL LIABILITIES	$
		NET WORTH	$
TOTAL ASSETS	$	TOTAL LIABILITIES AND NET WORTH	$

SECTION 4 — SOURCES OF INCOME

For Year Ended ______ 19__		Annual Expenditures		Contingent Liabilities			Estimated Amounts
Salary	$	Mortgage/rental payments	$	Do you have any . . .	Yes	No	
Bonuses & commissions		Utility payments		Contingent liabilities (as endorser, co-maker or guarantor)?	☐	☐	$
Dividends & interest		Real estate taxes & assessments		Involvement in pending legal actions?	☐	☐	
Net real estate income (before debt service)		Taxes — federal, state & local		Other special debt or circumstances?	☐	☐	
Other income (specify)		Insurance payments		Contested income tax liens?	☐	☐	
		Other contract payments (car payments, charge cards, etc.)		If "yes" to any question describe:			
(Alimony, child support, or separate maintenance income need not be revealed if you do not wish to have it considered as a basis for repaying this obligation.)		Alimony, child support, maintenance					
		Other expenses					
Total Income	$	Total Expenditures	$	Total Contingent Liabilities			$

Income tax settled through (date) ______

Have you ever been declared bankrupt? ☐ Yes ☐ No
If Yes, describe on separate sheet

99-0266 **(Complete schedules and sign on reverse side)** BANK ONE is an affiliate of BANC ONE CORPORATION, Columbus, Ohio

SCHEDULE A — BANKS, SAVINGS & LOANS, CREDIT UNIONS (ETC.) WHERE FUNDS ARE ON DEPOSIT

Name of Institution	Location	Type of Deposit (checking, savings, etc.)	Name(s) of Owner(s)	Amount on Deposit

SCHEDULE B — U.S. GOVERNMENTS & MARKETABLE SECURITIES

Number of shares or face value (bonds)	Description	In name of	Market Value	Amount of loans against securities

SCHEDULE C — NON-MARKETABLE SECURITIES

Number of shares	Name of corporation	Location and nature of business	% ownership	In name of	Amount of loans against securities	Value	Source of Value

SCHEDULE D — REAL ESTATE (WHOLLY OR PARTIALLY OWNED)

Address and Type of Property	Title in Name of	% of Ownership	Date Acquired	Cost	Market Value	Monthly Payment	Mortgage Balance	Mortgage Maturity

SCHEDULE E — LIFE INSURANCE CARRIED, INCLUDING N.S.L.I. AND GROUP INSURANCE

Name of insurance company	Owner of policy	Beneficiary	Face amount	Policy loans	Cash surrender value

SCHEDULE F — BUSINESS VENTURES

List Name and Address of Any Business Venture in Which You Are a Principal or Partner	Book Value As Listed in Section 3	Your % of Ownership	Your Position/Title in the Business	Total Assets of Business	Line of Business	Years in Business

SCHEDULE G — NOTES PAYABLE

Name and Address of Creditor	Purpose of Loan	Original Loan/ Line Amount	Date of Loan	Maturity Date	Unsecured or Secured (List Collateral)	Current Balance	Payment Schedule

The information contained in this statement is provided for the purpose of obtaining or maintaining credit with BANK ONE on behalf of the undersigned, or persons, firms or corporations in whose behalf the undersigned may either severally, or jointly with others, execute a guaranty in favor of BANK ONE. Each undersigned understands that BANK ONE is relying on the information provided herein (including the designation made as to ownership of property) in deciding to grant or continue credit. Each undersigned represents and warrants that the information provided is true and complete and that BANK ONE may consider this statement as continuing to be true and correct until a written notice of a change is given to BANK ONE by the undersigned. As long as a loan or commitment to lend is outstanding, the undersigned agree to update this financial statement for BANK ONE at least annually. BANK ONE is authorized to make all inquiries it deems necessary to verify the accuracy of the statements made herein, and to determine my/our credit worthiness. BANK ONE is authorized to answer questions about its credit experience with me/us.

Signature (Individual) ____________________

S.S. No. ____________________ Date of Birth ____________

Date Signed ____________________

NOTICE: The Ohio Laws against discrimination require that all creditors make credit equally available to all credit-worthy customers, and that credit reporting agencies maintain separate credit histories on each individual upon request. The Ohio Civil Rights Commission administers compliance with this law.

Signature (Other party) ____________________

S.S. No. ____________________ Date of Birth ____________

Date Signed ____________________

BUSINESS LOAN APPLICATION

I. Application Information

Applicant Name (hereinafter "Company") Federal Tax Identification Number

Street Address City State Zip

II. Principal Owners

(20% or more ownership)

Name and Title

Principal Contact Telephone Number

Name and Title

Principal Contact Telephone Number

III. Information on Existing Business

☐ Corporation ☐ Partnership ☐ Proprietorship ☐ Other:

Business Legal Structure Gross Annual Sales

IV. Purpose of the Loan

Amount Requested

Purpose of the loan/Use of Funds

If the purpose of this loan is for the purchase, repairing, rehabilitating, remodeling, or refinancing of a residential structure (a home, condominium unit, cooperative unit, mobile or manufactured home or multifamily dwelling), the loan officer must check this box and complete a HMDA Reporting Form. ☐ Term of Loan:________________

BANK ONE may check credit and trade references in reviewing this application, and disclose information about its credit experience with Applicant, as authorized by law. BANK ONE may also check the personal credit history of the principal owner and/or key individual.

Ohio laws against discrimination require that all creditors make credit equally available to all creditworthy customers, and that credit reporting agencies maintain separate credit histories on each individual request. The Ohio Civil Rights Commission administers compliance with this law.

As an authorized agent of the applicant company, I have stated that everything in the application and information submitted along with the application is true.

Authorized Signature (Must be officer of company) Title Date

Authorized Signature Title Date

Authorized Signature Title Date

If partnership, all partners must sign; otherwise, partnership authorization required.

PERFORATED TEAR SHEET BELOW

Creditor's Name: BANK ONE, COLUMBUS, NA Creditor's Address: 100 E. Broad St., Columbus, OH 43271

If your application for business credit is denied, you may have the right to a written statement of the specific reasons for the denial. To obtain the statement, please contact ________________ within 60 days from the date you are notified of our decision. We will send you a written statement of reasons for the denial within 30 days of receiving your request for the statement.

NOTICE: The Federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants on the basis of race, color, religion, national origin, sex, marital status, age (provided the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The federal agency that administers compliance with this law concerning this creditor is Comptroller of the Currency, Consumer Examination Division, Washington, D.C. 20219

ACTIVITIES

The following activities are designed to help you apply what you have learned in this unit.

INDIVIDUAL ACTIVITIES

A.

Using the work sheet forms provided by your instructor, determine the total amount of money needed to get your business started. Include start-up costs, monthly operating expenses, and personal living expenses.

B.

Using the information developed in the first activity, prepare the following financial statements:

- A projected income statement
- A projected cashflow statement
- A personal balance sheet

C.

Using the guidelines in the Bank One Business Loan Kit to fill out a loan application package for a business of your choice.

GROUP ACTIVITIES

A.

Work in teams of three or four students. Each student in the group should explain his or her start-up costs and monthly operating expenses estimate, financial statement, and loan application package.

Group members should carefully consider one another's presentations, and then comment on the following:

- Are the start-up costs and monthly operating expenses complete? Should others be included? Are the figures realistic? Suggestions?
- Are the financial statements complete? Is the sales volume estimate realistic? Are the calculations mathematically correct? Suggestions?
- Is the loan application package complete? Does it have a neat and businesslike appearance? Should any information be deleted? Should any additional information be included? Suggestions?

B.

Work in teams of two. One person is to role-play the financial expert (i.e., the banker), and while other role-plays the loan applicant (i.e., the entrepreneur).

The entrepreneur is to fill out a business loan application and submit it to the financial expert. If you cannot secure this kind of application form your local banker, you may use a copy of the Bank One business loan application preceding the Activity section. The loan officer should read the information on the loan application before meeting with the entrepreneur.

Next, set up a video camera to record the meeting of the banker and entrepreneur. For this activity, assume that the banker is a commercial loan officer who specializes in businesses similar to that of the entrepreneur. The discussion should focus on the major assumptions of the business plan (e.g., profitability forecasts, sales growth, cost of sales, growth, market conditions, customer base, product features, legal issues, capital provided by the entrepreneur, etc.).

Finally, the banker and the entrepreneur will watch the video tape and assess the effectiveness of their meeting. Use the feedback to improve communication skills for future similar situations.

CASE STUDY

Mr. and Mrs. Harold DeBusko are very interested in opening a hobby and craft store. They are currently trying to determine how much money is needed to start their business. They have already agreed that the store must make $25,000 net profit the first year so they can pay all their personal living expenses.

Through their investigation of financing, they have discovered the following information about hobby and craft stores:

- They usually operate on a gross margin of 50 percent.
- Overhead costs are 40 percent of gross sales.
- The average rate of inventory turnover is six times per year.
- The rate of net profit on sales is 10 percent.

DISCUSSION QUESTIONS

1. Assist the DeBusko family in developing an operating ratio analysis.
2. Investigate what the financing needs of the store are.
3. Show DeBuskos how to calculate the following:
   - Their first year sales goal
   - Cost of merchandise sold during the first year.
   - Monthly overhead cost
   - Cost of beginning inventory

ASSESSMENT

Read the following questions to check your knowledge of the topics presented in this unit. When you feel prepared, ask your instructor to assess your competency on them.

1. Describe the sources of information available to use in estimating the financing necessary to start a new business.

2. Explain the steps involved in determining the financing needed to start a new business.

3. List the steps involved in preparing both a projected income statement and a projected cashflow statement.

4. Explain how you would anticipate questions regarding the validity of financial projections needed to start a new business and justify your answers to these questions.

5. Describe the five basic parts (and their contents) in a loan application package.

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The State of New Mexico Small Business Development Program.

PACE

Units on the above entrepreneurship topics are available at the following levels:

* Level 1 helps you understand the creation and operation of a business
* Level 2 prepares you to plan for a business in your future
* Level 3 guides you in starting and managing your own business