Inc.

# How To *Really* Start Your Own Business




IN COOPERATION WITH

SCORE™

FOR THE LIFE OF YOUR BUSINESS

www.score.org

SPONSORED BY

THE COMPANY CORPORATION®

www.incorporate.com/score

# Contents






Sponsored by The Company Corporation® (**www.incorporate.com/score**) in cooperation with SCORE (**www.score.org**).

The material in this workbook is based on work supported by the U.S. Small Business Administration (SBA) under cooperative agreement number SBAHQ-11-S-0001. Any opinions, findings and conclusions or recommendations expressed in this publication are those of the author(s) and do not necessarily reflect the views of the SBA.


THE COMPANY CORPORATION®
**www.incorporate.com/score**

Dear Business Owner,

Congratulations on taking the first step toward starting your own business! We hope we can help you achieve your American dream.

The Company Corporation (www.incorporate.com/score) has helped more than half a million small business owners like you incorporate their companies or form LLCs. We provide a range of products and services that are essential when launching, growing, and managing a business.

We know that starting a business can be a little intimidating. That's why we've partnered with SCORE and the editors of Inc. magazine to bring you this workbook. In the pages that follow, you'll find topics ranging from testing your business idea to creating a plan, structuring your company, and building a successful team. By the time you're done reading, you'll know much more about cash control, financial management, funding a business, building business credit, and a number of other vital topics.

We're honored to provide this tool for use by SCORE mentors and their clients. SCORE mentors volunteer their time and expertise to help small businesses with free and confidential business mentoring. The SCORE Association has helped more than ten million small business clients since 1964.

Small businesses are the backbone of our country's economic growth. It's our goal to make sure you always have the tools to succeed.

Best regards,

E.J. Dealy

E.J. Dealy
Chief Executive Officer
The Company Corporation


**Our website: www.incorporate.com/score**
**866-544-6804**


*The Company Corporation is a service company and does not provide legal or financial advice.*

CHAPTER 1

# Summarize Your Idea

**Remember the following about any idea for a new business:**

- Always be on the lookout for ideas. They can come from anywhere: your work experience, a hobby or even your experiences as a consumer when an existing product or service doesn't meet your needs.
- Identify a niche. Usually the niche or opportunity will be an innovation or proven idea in a new market or a unique idea in an existing market.
- Learn everything you can about the business you want to start and the marketplace you'll be operating in. This means getting work experience and collecting information so you'll know the industry inside and out.
- Make sure your idea is focused so that you can express it clearly in 50 words or less.

**Summarize your business idea in 50 words or less:**

**Begin testing your idea by asking probing questions. Put answers in writing. Do this for each idea you have:**

**1.** Where did your idea originate (from a specific experience, industry observation, a sudden inspiration)?

**2.** If your idea is for a new product or service, describe how you expect to get it accepted in the market.

**3.** If your idea is for an improvement or variation of an existing product or service, describe why consumers will use it instead of what is already available.

4. Describe your market niche in 50 words or less.

5. List at least three qualifications that you have that will allow you to pursue a business in this market niche (work experience, education, research, reputation, etc.).

6. What are your two most important personal goals for the next five years (independence, visibility, income, personal satisfaction, etc.)?

7. How will this business help you achieve those personal goals?

8. List and describe briefly the two most significant barriers to expect while launching and operating your business.

9. Explain how you expect to overcome these challenges.

## Take These Five Steps to Jumpstart Your Business Planning

1. Clearly define your business idea. Be able to state the purpose and goal of your business using clear and simple language. Know your mission.
2. Examine your motives. Make sure you have a passion for owning a business and for this particular business.
3. Be willing to commit to the hours, discipline, learning and frustrations that are common to owning a business.
4. Conduct a competitive analysis in your market, including products, prices, promotions, advertising, distribution, quality and service. Be aware of the outside influences that can affect your business.
5. Seek help from other small businesses, vendors, professionals, government agencies, employees, trade associations and trade shows. Be alert, ask questions and visit your local SCORE chapter. (Visit **score.org** for more information)



# Test Your Idea

**As you evaluate your idea, keep in mind the following:**

- Market research doesn't have to be complicated or expensive, but you must do it.
- Conduct research to determine whether there is an adequate number of potential customers to support your product or service. Use the following sources for statistical and demographic information:
    - **Libraries and published directories (e.g., Gale Research directories)**
    - **Computerized databases (available at many libraries)**
    - **Websites and search engines (posted by business resources and public agencies)**
    - **U.S. Small Business Administration (1-800-U-ASK-SBA; www.sba.gov)**
    - **U.S. Bureau of Census (www.census.gov), U.S. Dept. of Commerce (www.doc.gov)**
    - **Trade associations for your industry**
    - **Local chambers of commerce**
- Test your idea with potential customers and others who can offer constructive feedback (e.g., friends, relatives, bankers, suppliers, executives). Keep a written record of the responses.
- Be prepared to make changes based on the responses.
- Study and evaluate the competition.
- How will your product or service be an improvement over the competition?
- Price your product competitively—higher if your product or service improves on an existing one and lower if it will be equal to what is on the market. Be sure you can make a profit long-term.

**For each of the following categories, list two potential sources (with location and phone number) who can comment candidly about your business idea:**

Bankers (check your local Yellow Pages under "Banks")

Trade Associations (search the Internet or check the *Encyclopedia of Associations*, available in most libraries)

Government or University-affiliated Organizations (call your SBA district office, SCORE, chapter or the nearest Small Business Development Center)

Successful Entrepreneurs (from magazine or newspaper articles and local references)

Suppliers (check local Yellow Pages, classified advertisements and publications such as the *American Wholesalers and Distributors Directory*, available at major libraries)

**Answer the following questions about your market:**

**1.** Identify your three most important groups of potential customers, defining them by the criteria (e.g., age, demographics, industry, etc.) that you believe are most relevant to your product or service.

a. ______________________________

b. ______________________________

c. ______________________________

**2.** Name your primary competitor for each of the three groups.

a. ______________________________

b. ______________________________

c. ______________________________

**3.** Describe how each group feels about this competitor.

a. ______________________________

b. ______________________________

c. ______________________________

**4.** Describe the factors that are most likely to make each group leave a competitor and switch to your product or service.

a. ______________________________

b. ______________________________

c. ______________________________

**5.** Where did the answers to questions 3 and 4 come from (printed pieces, market study, questions to prospective customers, etc.)?

a. ______________________________

b. ______________________________

c. ______________________________

**6.** Describe what makes each of your competitors successful.

a. ______________________________

b. ______________________________

c. ______________________________

**7.** Describe what makes each competitor vulnerable to loss of customers.

a. ______________________________

b. ______________________________

c. ______________________________

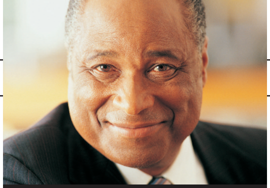
**Answer the following questions about your pricing policies:**

**1.** Provide details and/or a calculation of how you arrived at the price for your product or service.

**2.** List the price(s) that your most significant competitors charge for their corresponding product or service.

**3.** If your prices are higher, why? How will you justify them to your customers?

**4.** If your prices are lower, why? How will they help you attract customers?



CHAPTER 3

# Protect Your Idea

Start-up entrepreneurs tend to worry about having their business ideas stolen, but it is important to keep this issue in perspective:

- Don't worry about protection so much that it interferes with your test marketing and test development.
- Be discrete about revealing details of your business idea, particularly with competitors.
- If you think your idea qualifies for legal protection, speak with a lawyer. The protection options are:

**Patent** (to protect an original device or process)

**Copyright** (for printed material, such as consulting manuals, books and maps or computer software)

**Trademark** (to guard a product name, logo, symbol or figure)

**Service mark** (to guard a brand or service name, logo, symbol or figure)

**Here are eight basic steps to ensure that you have sufficient legal protection:**

1. For the best protection against having your business idea stolen, be sure you know the character of every person with whom you discuss the idea.
2. If you share copies of your business plan, be sure to number each one and record the name of the individual who receives it.
3. Ask those who will review your business plan to sign a nondisclosure agreement that prohibits them from using or discussing the information.
4. Be sure any employment agreements limit the ability of someone who leaves your company to use proprietary materials, designs and formulas or to take customer names with them.
5. File for a patent to prevent others from copying your invention.
6. File for a copyright to prevent others from copying your material, including print, software, music, films, art and recordings.
7. Register your trademark to prevent others from using a special name or logo you plan to use.
8. To protect your ownership rights, obtain the services of a qualified attorney who is experienced in matters involving intellectual property protection.

To obtain U.S. copyright forms or for more information about copyright protection, contact the Copyright Office, Library of Congress, Washington, D.C. 20559. For more information about patents and trademarks, visit the U.S. Patent and Trademark Office online at **www.uspto.gov**.



# Create a Business Plan

A well-written business plan will play a key role in the success of your business. In addition to being required to obtain certain loans, a carefully considered plan helps business owners focus on strategic objectives and communicate those objectives to staff. For those inexperienced in creating a business plan, free assistance is available from a variety of nonprofit sources, including SCORE and local Small Business Development Centers. Local banks can tell you what they look for in a business plan and an accountant can help you prepare the necessary financial statements. You also may use the cash flow worksheets found on SCORE's website, www.score.org.

**The planning process will not be intimidating if you keep these points in mind:**

- Planning ahead for your new business can mean the difference between success and failure.
- Use an informal plan consisting of three to six pages to convince relatives and friends to back your venture. Be sure to cover the first eight points cited below.
- To approach bankers, individual investors and venture capitalists, prepare a more formal written business plan. It shouldn't be longer than 40 pages and should be organized as follows:

1. **Executive Summary.** A two-page, succinct explanation of your business and its activities, with an overview of your key objectives and business goals.
2. **Business Description.** Describes your perception of the company. How will your business grow and profit?
3. **The Market and Competition.** Largest section. Honestly acknowledges competition and describes how your company will differ from other providers.
4. **The Product or Service.** Describes the core of your business.
5. **Marketing/Selling.** Explains how you will access the marketplace. Will you advertise, attend trade shows, establish a website?
6. **Management and Personnel.** Explains how you will staff and manage your business. It includes one-paragraph profiles—or biographies—of yourself, partners and any other key team members.
7. **Financial Data.** Contains the balance sheet, profit-and-loss statement, break-even chart and cash flow analysis.
8. **Investment.** Based on cash flow, it includes what the investor will receive as a return.
9. **Appendices.** Includes testimonials from potential customers, research clips, charts and graphs relevant to your business.

**To create a successful business plan, consider these three questions:**

1. Which type of business plan (informal, less than 10 pages; or more formal, up to 40 pages) is most appropriate for your business? Why?
2. Outline the sections of your plan (see list above). How long should each section be?
3. Identify areas that require more work on your part, as well as areas that you are ready to put into writing.

## Need Help With Your Business Plan? Contact SCORE

**SCORE, Mentors to America's Small Business,** is a nonprofit organization dedicated to helping entrepreneurs succeed as small business owners. More than 12,000 volunteer business mentors in over 340 chapters nationwide are available to provide you with advice, mentoring and small business planning assistance. SCORE business mentoring is free and confidential. You can rely on SCORE as a trusted resource to help you plan for success.

Since 1964, SCORE has assisted more than 10 million aspiring entrepreneurs and small business owners just like you through mentoring and business workshops. For more information about starting or operating your own business, call **1-800-634-0245** for the SCORE chapter nearest you. Or, visit SCORE on the Web at **www.score.org**.


CHAPTER 5

# Choose a Structure

For legal and financial purposes, your business must have a formal structure. There are four basic choices:

1. **Sole proprietorship.** The owner and the business are the same (often a service business, with the owner providing the service). Business and personal tax returns are filed together.
    - Advantages: Simple and inexpensive (start-up costs are low); maximum control.
    - Disadvantages: Unlimited personal legal and financial liability; limited ability to raise capital; not an enduring structure.
2. **Partnership.** A business with more than one owner; divides profits and losses among participants. It may be popular for lawyers, doctors and other professional service providers, but not for most new businesses.
3. **Incorporation.** A safer choice for businesses that have employees or bank financing. A corporation is a state-chartered organization owned by shareholders. The shareholders can elect or appoint a board of directors who are ultimately responsible for management of the business.
    - Advantages: Personal assets are protected from the debts and risks of the business. This is especially important if the business fails or is sued.
    - Disadvantages: Corporations must hold meetings and file annual reports resulting in paperwork.

    **C Status.** So-called because it is taxed under regular corporate income tax rules.
    - Advantages: Limited liability; access to capital (can raise money through sale of stock); perpetual life (unlike sole proprietorship); ownership can be transferred.
    - Disadvantages: Profits are subject to double taxation (corporate income is taxed and stockholder dividends are also taxed as part of the individual's income); regulation and paperwork; some limited start-up costs including state filing fees.

    **S Status.** So-called because it is under subchapter S of the Internal Revenue Code; also known as a "Sub Chapter S."
    - Advantages: Appropriate for start-ups; limits personal liability; S corp dividends are not subject to self-employment taxes; eliminates double taxation.
    - Disadvantages: Taxes may be imposed on some shareholder benefits; number of shareholders is restricted to 35.
4. **Limited Liability (LLC).** State-chartered organization that allows for the reduced personal liability of a corporation, but with the tax advantages of a partnership or sub chapter S.
    - Advantages: Liability protection; no ownership restrictions; no double taxation; easier access to capital (compared with partnership); like a S status corporation with less paperwork; less formal; less paperwork than a corporation.
    - Disadvantages: Stock not available.

**Select the structure that best suits your new company's needs.**
If you answer yes to any of these questions, incorporating your business may be the right step for you.

1. Would you like to protect your personal assets against liabilities that your company may incur, either in the form of debt or lawsuits?
2. Would you like the option to raise capital through the sale of stock?
3. Do you have—or plan to have—employees?
4. Do you have co-owners or investors?
5. Do you want your business to continue to operate after your death or a partner's death?
6. Would including "Inc.", "Corp." or "LLC" as part of your business name enhance your credibility with investors, suppliers and customers?

## Ways to Organize Your Business

| | C Corporation | Subchapter S Corporation | Limited Liability Company | General Partnership | Sole Proprietorship |
|---|---|---|---|---|---|
| Owners have limited liability for business debts and obligations | ✓ | ✓ | ✓ | | |
| Created by a state-level registration that usually protects the company name | ✓ | ✓ | ✓ | | |
| Business duration can be perpetual | ✓ | ✓ | ✓ | | |
| May have an unlimited number of owners | ✓ | | ✓ | ✓ | |
| Owners need not be U.S. citizens or permanent residents | ✓ | | ✓ | ✓ | ✓ |
| May be owned by another business, rather than individuals | ✓ | | ✓ | | |
| May issue shares of stock to attract investors | ✓ | ✓ | | | |
| Owners can report business profit and loss on their personal tax returns | | ✓ | ✓ | ✓ | ✓ |
| Owners can split profit and loss with the business for a lower overall tax rate | ✓ | | | | |
| Permitted to distribute special allocations under certain guidelines | | | ✓ | ✓ | |
| Not required to hold annual meetings or record meeting minutes | | | ✓ | ✓ | ✓ |

CHAPTER 6

# Designate a Registered Agent

**STATE LAWS REQUIRE** that you have an "agent" of the corporation or LLC who is responsible for receiving and forwarding vital legal and tax documents. If you form a corporation or LLC, then the designated registered agent must be a resident of the state of the corporation or LLC formation. The address of the agent must be a physical address, not a post office box, and it must be open during all normal business hours.

Your agent serves as a critical conduit for managing ongoing legal requirements associated with your company. Your agent receives official state and federal mail, such as tax forms and annual report notices. The agent may also be served with legal papers (notice of litigation) if a lawsuit is filed against the corporation or LLC.

The person designated to be the registered agent may or may not be affiliated with the corporation. The agent may be an employee, officer, director or shareholder of the corporation, or may be a third party.

You may serve as your own agent, with your principal office as the registered agent address. However, most business owners choose a third party to act in this capacity, for one or more of the following reasons:

**Availability.** You may be out of the office when key legal documents requiring immediate action might be delivered. If you are not there to respond promptly to a notice of litigation, for example, you could get a default judgement against you for failing to answer a claim in a timely manner.

**Privacy.** Having a legal process server show up would disrupt your business and be an embarrassment in front of customers, employees or neighbors. A third-party agent offers a layer of privacy, protecting you from publicly being served at your place of business and making your personal address less accessible to strangers.

**Location.** There is a possibility that you might relocate your business in the future. Maintaining an outside registered agent enables you to change the location of your company without filing a costly change of address with the state.

**Documentation.** The paperwork involved in being your own agent would take up too much of your time, or you might simply prefer to have a third party remind you when it's time to file important documents.

Many small business owners turn to an incorporation service company to serve as their registered agent. Corporations that sign on with an agent service are often those that are incorporated in one state and operating in another.

## Choosing a Registered Agent

- ❑ **RESIDENCY:** must be a resident of and have an office in the state in which you incorporate; sometimes referred to as a "resident agent"
- ❑ **AVAILABILITY:** must be available during all normal business hours
- ❑ **RELIABILITY:** can be counted on to promptly notify you of the receipt of important state and federal documents or notices of litigation
- ❑ **CONFIDENTIALITY:** can be trusted to keep potentially sensitive legal issues *confidential*

**Candidates:**

**1.** ______________________

**2.** ______________________

**3.** ______________________

**4.** ______________________

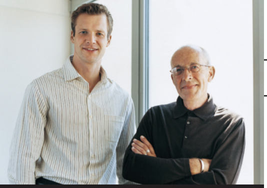
**5.** ______________________

**6.** ______________________

**7.** ______________________

**8.** ______________________

* Service companies often act as the registered agent for small businesses nationwide.



CHAPTER 7

# Lock in Your Location

**WHERE SHOULD YOU INCORPORATE?** That depends on whether you will do business outside your home state. If not, forming a corporation in your state will generally require less paperwork and less cost. You will only need to account for income generated in one state while filing one state tax return and one set of corporate notices. Plus, you will avoid paying franchise taxes and filing annual reports in more than one state.

If you incorporate in another state, such as Delaware or Nevada, you may need to submit an application to qualify as a "foreign" (out-of-state) corporation in the state where you are located. Without qualifying to do business locally, it could be difficult to open a bank account in your company's name.

If you plan to do business in more than one state, look at which state requires the least amount of paperwork and has the least expensive incorporation fees. Also consider corporate and personal income tax rates and compliance regulations. If you plan to expand the business rapidly or go public—or if you intend to seek venture funding—many accountants and lawyers would recommend incorporating in Delaware or Nevada.

**Delaware** has low incorporation and LLC formation fees, low annual franchise taxes and no state corporate income tax for companies that operate outside Delaware. It also has no minimum capital required for incorporation and one person can hold all corporate offices. Shares of stock owned by nonresidents are not subject to Delaware personal income tax or inheritance tax. You need not have an office or bank account in Delaware, just a registered agent, and names of initial directors need not appear in public records. With its separate "Chancery Court" for business disputes, Delaware's court system facilitates speedy dispute resolution.

More than half of the New York Stock Exchange companies are Delaware corporations. If you plan to go public, the stock market respects Delaware. Venture capital investors tend to favor Delaware corporations because they want the companies they fund to go public as soon as possible.

**Nevada** has no state tax on corporate profits, no state annual franchise tax and no state personal income tax. Stockholders of Nevada corporations are not a matter of public record, which provides privacy.

On the downside, Nevada companies may need to qualify or register to do business in their local jurisdiction. That may result in an additional fee to the state where you operate the business. Plus, Nevada's corporation and LLC formation fees are higher than many states.

A corporation with business sites in multiple states will typically incorporate or form an LLC in a single state, then qualify to do business in other states. This requires formally registering in those states, paying additional franchise taxes and filing annual reports. An incorporation service firm can help you file state qualifications as needed.

Your decision on where to incorporate affects your business on many levels. If you expect fast growth in many states or want to establish partnerships around the country, you may prefer to incorporate in Delaware or Nevada. This is more convenient than repeatedly starting—and dissolving—in-state companies as you move around the nation.

Because liability protection varies by state, you may also consider incorporating in business-friendly Delaware or Nevada if you engage in a higher-risk industry.

## Choosing a State

- ❑ Will you be doing business in one state or several states?
- ❑ Do you plan to go public?
- ❑ Will you seek venture capital?
- ❑ What is the state's corporate income tax, if any?
- ❑ What is the state's personal income tax, if any?
- ❑ What are the state's filing fees and annual franchise tax?
- ❑ Are there capital requirements for incorporating in that state?

CHAPTER 8

# Focus on Funding

At some point, no matter how carefully you monitor your cash flow, you will have to borrow money from a financial institution. There are two main reasons to borrow: to cover a temporary cash flow gap and to provide working capital for the growth of your business.

Plan ahead. A written financial plan—whether for a bank or internal use—is a major step in the right direction. A financing plan helps you avoid the causes of cash flow problems, anticipate financing needs (for growth or for survival) and helps keep your total borrowing under control.

A financing plan spells out responses to such questions as: What are the business's needs? Why can't they be met from retained earnings? Are operating profits going to be available to meet long-term debt? How much is needed, when and under what terms? Most important, the plan should provide an answer to the banker's biggest question: How will this loan be repaid?

You must be able to show that you can afford to service the loan. One classic way small businesses trip themselves up is to use this year's financing to pay off last year's debt. This "pyramiding" is doubly defeating. It creates a larger debt load than is wise and it is very discouraging to be always struggling with debt even while profitability is increasing. Be wary of using financing to conceal operating losses.

### How do you put together a financial plan?

Start by identifying your business's different needs for funds. Most of these will be covered by operating profits. Those that can't (or can't without making the liquidity vanish) should be carefully analyzed to see whether more debt should be sought. It's important to remember that if debt financing is needed to cover a cash flow gap ordinarily caused by insufficient operating profits, the underlying cause of the shortfall must be identified and dealt with before financing will do any good. Borrowing to "paper over" an operating problem always leads to a worse situation, tempting though it may be at the time.

Suppose, for example, that your sales have fallen off and costs have risen, making it clear that soon you'll have a severe liquidity or working capital problem. If the lag in sales can be cured without borrowing, fine. (You can almost always take costs down a few notches.) If you still have cash flow problems, then make sure that the borrowing won't make it worse. If the sales problem can't be resolved, sooner or later you'll be back to the bank to borrow more, thus driving costs even higher.

Make sure you know your needs before going to the bank—both in dollar terms and in the benefits that cash inflow will have for your business. Any banker you'd want to work with will ask what you need the money for and whether you could raise it from operations. To admit that you haven't looked at operating cuts and profits as a way to generate money is a sure way to lose credibility. Enter the bank well-prepared.

Legitimate financing needs fall into five related categories. At any one time your needs may overlap several of these categories. A start-up, for example, may face radical expansion, perhaps requiring an acquisition or the launch of a new division.

1. **Start-ups.**
   A new business needs a combination of investment capital and long-term debt. One error that cripples a lot of small businesses is the use of short-term debt to finance long-term needs. The basic rule in financing is to match the term of the loan to both the term of the need and to the source of repayment. Using a 90-day note for permanent financing needs is very risky. Not only is there the ever-present danger that the loan will not be renewed, but there is the added disadvantage of never being able to plan more than 90 days ahead.

2. **Working capital shortages.**
   After initial capitalization, working capital should be generated from operating profits over a long period. If you suffer from chronic working capital shortages due to undercapitalization but are making some operating profits, then the answer may be a term loan if you can demonstrate that the loan will more than repay itself in additional operating profits. Sometimes a modest working capital loan will put a business over the hump, affording enough breathing room to make much higher operating profits.

   But remember, a working capital loan, which is paid back monthly over a period of up to three to seven years, adds to any existing financial strain. If your business won't generate sufficient operating profits to cover the payments comfortably, then added equity is needed, not more debt.

3. **Equipment and other fixed assets.**
   Equipment and other fixed-asset loans are about the clearest examples of matching a loan to the need and payment base. Since these loans are ordinarily secured by the equipment, the anticipated useful life of the equipment becomes a major factor in the credit decision. A rough guideline is that you can finance equipment with a projected useful life of 10 years for up to 70% of its life and up to 90% of its value.

   Don't buy fixed assets on 90-day notes. The timing is wrong. If you're trying to make your business work on sweat equity, you may want to go ahead and pay off a piece of equipment more rapidly than we'd recommend. That's an option, but a hard one to live with.

   While equipment loans rarely go beyond 7 years, commercial real estate may be financed for 10 or more years, depending on the situation. Since you are building equity in equipment and real estate from profits for a number of years, you should finance it the same way.

4. **Inventory, seasonal progress.**
   These loans are short-term and are usually tied to a clearly defined source of repayment, such as one inventory turn, fulfillment of a contract or sale of a specific asset.

   Short-term notes are repaid from short-term sources, clearly identified before the credit is granted. Medium- and long-term debts are repaid from more indirect sources. A banker looks to proven management ability (usually evidenced by a profitable history and clearly understood plans) for repayment. Since there is no single, fast source of repayment, the risk is greater and the decision more difficult. This is a crucial distinction. A poorly run company may be a good short-term credit risk, but for long-term credit, a business must show the ability to consistently generate profits.

   Remember, term loans come due every month, adding to the drain on resources and, in turn, increasing the risk and need for more careful financial management.

5. **Sustained growth.**
   The final major need for financing is growth, which can outstrip working capital. As sales go up, liquidity often goes down. A combination of investment, lines of credit to receivables and inventory and long-term working capital loans is the common answer.

   Notice what this implies. If you plan to grow, you must plan to generate profits consistently, while at the same time keeping your business liquid to meet current obligations. To make sure that you maintain liquidity, you have to be certain of your financing strategy. The answer? A solid financial plan. (For help in creating a sound financial plan, contact your nearest SCORE chapter. See page 9.)

Work with your banker. If you aren't comfortable preparing a financing proposal, complete with financial statements or if you feel that your banking relationships could be improved, get your banker involved in your long-term planning efforts.

Like all business professionals, bankers like to use their skills. Since most businesses suffer from a lack of financial management skills and since most bankers have these skills, it is to your advantage to make the first move. Invite your banker to help you. Level with him or her. If you can't keep communications open, then you won't get help—and it's quite possible that you won't get the financing you need. By being open, you'll enhance your credibility. And better yet, you'll more likely find that you can turn the banker's skills into a positive resource rather than a roadblock.

## Using Credit Wisely

Managing cash and securing capital are the two biggest challenges small business owners face—particularly in the start-up phase. To keep personal expenses separate from business expenses, use business credit cards as money management tools. Here are three ways they will help you:

- *Business credit card:* Use it to make and manage purchases, as well as cover travel and entertainment expenses. Like a reserve of credit, a business card gives you the flexibility to pay bills in full or revolve your balance.
- *Business check card:* An ideal replacement for cash and checks—with the convenience of a debit card—check cards allow you to draw on funds from a business checking account. They are excellent for start-ups, since they allow your company to establish a business relationship with your bank.
- *Business credit line:* Providing an unsecured line of credit up to $50,000, the credit line gives businesses a source of working capital for emergencies or growth opportunities.

*Caution: If you are a sole proprietor or partnership, you are personally responsible for your business debt. Forming a corporation or LLC separates your business debt from you personally.*

# Get a Fix on Financing

**To obtain the funds to launch your business, here are six avenues to explore:**

**1.** Stick close to home. There may be more options than you think, including:
- Personal savings
- Business credit card
- Business credit line
- Business check card
- Second mortgage on your home
- Profit-sharing funds from your previous job
- Friends and relatives

**2.** If you need more than these sources can provide, consider:
- Bank loans
- Crowdfunding
- Private offering
- Limited partnership

**3.** Plug into a local network, including the following:
- U.S. Small Business Administration: 1-800-827-5722
- Nearest office SCORE chapter: 1-800-634-0245
- Nearest Small Business Development Center (SBDC) or your state economic development department
- Local business associations, such as the chamber of commerce
- State and locally sponsored small business conferences

**4.** Seek venture capital only if your business has the potential to achieve multimillion-dollar sales within five years. (For more information, contact the National Venture Capital Association at 703-524-2549 or the National Association of Small Business Investment Companies at 202-628-5055.)

**5.** Don't get bogged down hunting for funds; if you encounter problems raising money, try to start your business on a smaller scale.

**6.** Be sure you know your current credit history—for both you (personal credit rating) and your business. Try to find out which credit reporting service your prospective lender uses and request a report from that company. The three major credit reporting companies are: Dun & Bradstreet (1-800-234-3867), Equifax (1-800-685-1111) and Experian/TRW (1-888-397-3742).

## ABC's of Borrowing: Five Types of Business Loans, Terms and Purposes

| **Loan Type** | Credit Card | Credit Line | Short-Term Loan | Equipment/ Vehicle Loan | Commercial Real Estate Loan |
|---|---|---|---|---|---|
| **Term** | Evergreen | 12 months of evergreen | 90 day note | Up to 7 years | 10 years + |
| **Purpose** | • Cover travel, entertainment and office supplies | • Cover short-term cash-flow needs<br>• Carry accounts receivable<br>• Unexpected events | • Short-term items like inventory | • Purchase or refinance business equipment and/or vehicles | • Purchase or refinance commercial real estate |

**Use the five questions below to provide a framework for focusing on funding your business:**

**1.** List the banks in your area where you will apply for a loan and individuals who might provide you with introductions to bankers.

______________________________________________________________________________

______________________________________________________________________________

______________________________________________________________________________

**2.** Identify individuals at the bank to whom you should approach with your request.

a) ______________________________ c) ______________________________

b) ______________________________ d) ______________________________

**3.** What are the key questions you will ask your banker? (Find out how much experience the bank has in lending to your type of business, then ask about the lending/borrowing details—e.g., loan limits, collateral requirements, interest rates and other terms.)

______________________________________________________________________________

______________________________________________________________________________

**4.** How will you answer each of these five questions that the banker will inevitably ask you?

a) How much money do you need?
b) How long do you need it?
c) What are you going to do with it?
d) When and how will you repay it?
e) What will you do if you don't get the loan?

**5.** Should you seek venture capital rather than a bank loan? Begin answering this question by comparing the key factors bankers and venture capitalists focus on:

| **Banker** | **Venture Capitalist** |
|---|---|
| Collateral | Market demand for your market or service |
| Covenants in loan agreement | Equity position and value of stock |
| Ration analysis | Compound annual rate of return (typically 35% to 50%) |
| Ability to repay | Exit within 5 to 7 years |
| Financial statements | Management's background |

Both, of course, will expect you to present a sound business plan.

**Check the sources you plan to approach for funding:**

**Personal Resources**

- ☐ Savings
- ☐ Second mortgage
- ☐ Insurance
- ☐ Profit-sharing

**Close-to-Home**

- ☐ Friends
- ☐ Family

**Outside Sources**

- ☐ Bank loan
- ☐ SBA loan
- ☐ Business credit card
- ☐ Business credit line
- ☐ Venture capital
- ☐ Limited partnership
- ☐ Private offering
- ☐ Crowdfunding

CHAPTER 9

# Build a Team

**For your new business to have a chance to grow, it must have good people. With this in mind, be sure to do the following:**

**1.** Consider working with vendors, hiring contractors, or using temporary employees for routine tasks or special projects.. With employees comes payroll tax, HR issues and recordkeeping.

**2.** When it is time to hire, look for those who: a) share your values and goals for the business, and b) have winning attitudes and track records.

**3.** Approach investor relationships with caution. Describe everyone's responsibilities in writing and work with a lawyer on a buy-sell agreement that covers who owns what and how the partners can sell their shares to end the partnership.

**4.** Use outside advisers such as an accountant, a lawyer, a mentor and a board of advisers consisting of two to five professionals whose judgment you respect, including SCORE mentors.

**Personal assessment.** List your business-related strengths and weaknesses and likes and dislikes. Include personal traits, skills and behavior. For example, if you like numbers but dislike making presentations to groups of people, write that down. If you don't enjoy working with raw data or performing in-depth analysis, but would rather spend your time in people-oriented situations, then put that down. This exercise will enable you to determine the personal contributions that you will bring to your own company, as well as define the gaps that can be filled by hiring qualified key employees.

**Strengths** ______________________________

**Weaknesses** ______________________________

**Likes** ______________________________

**Dislikes** ______________________________

This should give you some specific ideas about the qualities you'd most like to see in your employees. Next, think about the skills, traits and backgrounds you would like them to bring to the business. List and prioritize them from the most to the least important:

______________________________

______________________________

______________________________

______________________________

______________________________

Based on the qualities above, write a job title and description for each of the key people you plan to hire:

a)______________________________

b)______________________________

c) ______________________________

d)______________________________

**Compensation**

**1.** How much would you expect to pay to outsource this role, such as bookkeeping, packing/shipping, etc?

______________________________________________

**2.** What is the market value for each job title or individual described at the bottom of page 16?

Title (a): ____________________ Salary: $ ____________________

Title (b): ____________________ Salary: $ ____________________

Title (c): ____________________ Salary: $ ____________________

Title (d): ____________________ Salary: $ ____________________

**3.** How much salary might he or she expect to receive from one of your competitors?

a) Starting salary: $ ____________ c) Starting salary: $ ____________

b) Starting salary: $ ____________ d) Starting salary: $ ____________

**4.** What salary are you prepared to offer?

a) Starting salary: $ ____________ c) Starting salary: $ ____________

b) Starting salary: $ ____________ d) Starting salary: $ ____________

**5.** What other forms of compensation or benefits might you provide in lieu of higher salary?

______________________________________________

______________________________________________

______________________________________________

**6.** When do you need to bring these people on board? (Create a schedule for when you plan to have each person working for your company.)

a) ____________________ c) ____________________

b) ____________________ d) ____________________

**Outside Advisers**

Name the outsiders who can contribute to your operation by providing valuable advice and services (e.g. bookkeeper):

____________________ ____________________

____________________ ____________________

____________________ ____________________

____________________ ____________________

**Telephone Equipment: How many lines do you need?**

Depending on the type of business that you run, your telephony needs are going to vary. While many businesses still use a traditional two-line phone system (one line for incoming calls and one for outgoing), the world of telephony is rapidly changing. For example, it used to be common place to have dedicated phone lines to receive faxes and for internet connections. Broadband internet and email have replaced each of these in many cases. Still, your needs will vary based on a number of factors. These include what type of business you are (home-based, phone sales, retail store, etc.), how many users of the phone system you will have, and whether or not you will need videoconferencing.

Here are 10 items you may also want to discuss with your phone company rep:

1. If you are setting up a home business, installing distinctive ringing will allow you to piggyback a different telephone number on your existing line, making it ring in a different tone and pattern.
2. If you want a separate telephone line in your home-based business, you can save money by installing a residential line. To obtain a business listing in the Yellow Pages, however, you need to install a business line.
3. If you don't mind being interrupted during a call, call waiting can notify you when another call is coming in. Customers often find this option annoying, however and business telephone etiquette experts suggest investing in voice mail, which allows customers to avoid a busy signal and leave a detailed recorded message.
4. If you want to be able to speak to several individuals in different places at the same time, you can arrange for conference calling.
5. When you frequently call the same numbers, speed dialing can save you time by allowing you to preprogram a one- or two-digit code into your telephone.
6. You can save money on calls of short duration if your telephone provider offers billing in six-second increments instead of full minutes.
7. Caller ID allows you to identify who is calling before you pick up your telephone.
8. When you sign up for additional telephone lines or services, inquire about installment billing, which allows you to spread out the payments over several months, often without finance charges.
9. If you're often away from your office and want your calls to follow you to another number, invest in call-forwarding options.
10. To encourage customers to contact you for information and orders, establish a toll-free number.

Another factor to take into account is how your phone system will interact with software that you may be using. If you use a Customer Relationship Management (CRM) system such as Salesforce.com or ACT , you may want to ensure that a record of all customer interactions can be recorded in the system. CRM systems are available for all types of business, and there is no size minimum for utilization. Another popular feature is email integration. This is where all marketing, sales, and service emails with a customer is recorded in your CRM. Many CRMs have mobile apps that facilitate this.

A very common practice in business today is for smartphones to be utilized. Many companies are electing to get rid of traditional phones in lieu of smartphones. Smartphones have a variety of productivity apps that can be downloaded for little or no money. They are also designed to send, receive, and view email on the fly, and to access the internet at very fast speeds. It is important to have an idea of how you plan to use mobile phones in your business.

CHAPTER 10

# Pin Down Your Company Name(s)

**EARLY IN YOUR** incorporation or LLC formation planning, choose—and reserve—the company name that will be included in your articles of incorporation, as well as the Internet domain name. You should have several alternative names in case your first choices are unavailable.

Your corporate name must be unregistered—that is, no other corporation in the state where you are filing already is using the name or a similar name. Also, each state has rules as to words that can (or cannot) be used in your name. Most states require that a word such as *Incorporated*, *Company* or *Limited* be included in your name; many prohibit the use of the words United States, Federal or National.

As a rule of thumb, you can select a name that will help identify the type of products or services your business provides. Or, you may prefer a name that conveys technical or professional expertise that will catch attention and be easy to remember. Sometimes the name(s) of the founder or founding members is used.

**Reserving your name.** As soon as you select a name, contact the secretary of state's office in your incorporation state or an incorporation service company to find out if it is available. If not, you will have to try other alternatives. If you have confirmation that a name is available, but you're not ready to file corporate papers, most states allow you to reserve the name for up to 60 days by filling out the appropriate form and paying the required fee.

If you will be doing business in more than one state, consider reserving your name in every state where you will be doing business prior to incorporating in any state. Otherwise, if your name is not available in another state, you will have to choose a different name before you can do business there.

**Winning the domain game.** For many companies, reserving an Internet domain name is as important as reserving a corporate name. Registering your domain name early in the incorporation process ensures that it will be available when you launch your website. With more than 400,000 domain names registered or transferred per day on the internet, online names are becoming scarce. The longer you wait, the less likely your preferred domain name will be available.

Ideally, your domain name will be the same as your corporate name or closely related. The easiest way to start selecting and reserving a domain name is to do a simple Web search under "domain name registration." You'll find a long list of accredited domain registration services that can check a name and register it if available. If a preferred name isn't available, many sites will offer suggestions for alternatives.

After completing your domain name search, check to see if your company name is already taken on Twitter, Facebook, Tout, and other social channels. To check the availability of an account name across various social platforms, use sites like **KnowEm.com** or **CheckUsernames.com**.

| Possible Corporate Names | Possible Domain Names |
|---|---|
| 1. | 1. |
| 2. | 2. |
| 3. | 3. |
| 4. | 4. |
| 5. | 5. |
| 6. | 6. |

CHAPTER 11

# Setting Up Shares

**IF YOU PLAN TO** incorporate your business as a C or an S status corporation, you have to indicate in the articles of incorporation the number of shares and classes of shares the corporation is authorized to issue. Each share of stock represents ownership in the company. Some corporations have a single shareholder, who may also be the only officer and director of the corporation. For others, the only shareholders are the husband and wife or family members. For still others, the shareholders and officers are the group of individuals involved in starting and managing the business.

The amount of authorized shares a corporation issues depends on the size of the business, its short-term needs and long-term plans. If you plan on going public or have private offerings to individuals in the future, for example, you may want to issue a sufficient amount of stock with that intent in mind. Perhaps you need capital or want to recruit an experienced professional team early on. Selling stock to prospective shareholders can raise money needed to fund growth. Prospective shareholders can also bring experience, contacts and professional skills to the corporation.

The different classes of stock determine how much money will be paid for each share and how dividends will be paid. Par value is the designated minimum price of an authorized share, below which it cannot be sold. No-par value stock has no stated minimum price; the shares may be issued for any price determined by the board of directors. No-par value is generally recommended because it allows the maximum flexibility to value shares later.

Most small corporations issue a single class of common stock, in which all shares have equal dividend and voting rights. Some C corporations also authorize preferred stock, which conveys preference on the right to receive annual dividends, among other things. The corporation must pay dividends to preferred stockholders before common stockholders. S status corporations may only issue a single class of stock and LLCs do not issue stock at all.

## Tuning in to a Sounding Board

Regardless of how small your corporation may be, set up a team of outside advisers to serve as a sounding board. Besides ideas and objective analyses, the board members can offer guidance in areas of outside expertise that could help you avoid financial and legal pitfalls. Here are five guidelines for building a board that can really help you:

- ❑ **COMPOSITION.** A good board consists of several unrelated counterparts. Your advisers might include an accountant, banker, attorney, insurance broker, CEO of a company in a related business or a business school professor.
- ❑ **SIZE.** Don't load your advisory board with so many people that you'll never get anything done. A good rule of thumb: five to seven members are all you need.
- ❑ **SCHEDULING.** Set up a regular meeting time—every month or quarter—depending on the complexity of the issues to be discussed. Schedule meetings with a SCORE mentor as an outside adviser.
- ❑ **PROFESSIONALISM.** Don't burden members with petty issues, such as what kind of computer to buy. Deal with wider issues, such as identifying emerging markets and ways to motivate your sales force.
- ❑ **COMPENSATION.** Be prepared to pay travel expenses and a small stipend to attract the best team.

CHAPTER 12

# Five Steps to Compliance

**AS A CORPORATION OR LLC,** you will have to satisfy federal, state and local regulations that apply to most enterprises. Beyond that, there are legal formalities and paperwork required for maintaining your corporate status.

One of the first things you must do after filing articles of incorporation is apply for a federal tax identification number. No bank will let you open a corporate bank account until you have one. The application form—SS-4 Application for Employer Identification Number—is available from the IRS and can be downloaded from its website, www.irs.gov. Many states have a similar form that must be completed.

Necessary licenses and permits for your business must also be secured. Your secretary of state's office is a good starting point for accessing information about which permits you will need, depending on the nature of your business. Some states have one-stop shops for accessing a single contract or form to complete their required registrations. Others involve a number of agencies—employment departments, workers' compensation divisions, revenue departments—to accomplish this task.

## Complying With the Rules and Regulations

Here's a sampling of the periodic paperwork required to retain your corporate or LLC status:

- ❑ Federal taxes (e.g., corporate income, Social Security, Medicare, unemployment)
- ❑ State taxes (corporate income; annual franchise; payroll, including unemployment, disability and workers' compensation; sales; certain property)
- ❑ Federal, state and local licenses and permits (certification, operating and safety)
- ❑ Shareholder agreements
- ❑ Company records (articles of incorporation and bylaws; personal; key transactions; minutes of meetings; etc.)
- ❑ State annual reports

It pays to research, in advance, which permits and licenses you'll need, some of which may include certain state and local environmental or zoning laws.

Employment regulations also should be near the top of your compliance checklist. Federal and state laws specify how often your employees must be paid and what you have to deduct from their paychecks. Federal taxes that must be deducted and recorded include income tax withholding, Social Security and Medicare taxes, and unemployment tax. On the state level, you also may have to withhold for income tax. And all states require that you have workers' compensation insurance before employees start their jobs.

To protect your status as a corporation, you must adhere to certain formalities and legal requirements. For example, to protect the personal liability of its shareholders, your company must perform as a corporation and be recognized as one. Not only must a separate identity be maintained, but personal financial matters and business matters must be kept entirely separate.

Here are five rules for protecting your corporate status and minimizing liability exposure for corporate activities:

**1. Keep your corporation or LLC in good legal standing.**

File all required reports on time, and don't neglect to pay your corporate taxes. Failure to plan for taxes—income taxes, payroll or other withholding taxes—is one of the primary causes of small business failure. Specific statutory authority allows federal and state officials to assess liability for certain unpaid taxes against individuals responsible for the corporation. Common targets are corporate presidents and treasurers, although directors and shareholders of small businesses may also be liable.

Most states require corporations to file an annual report and an annual franchise tax report; some have other forms that must be filed as well. Annual reports provide states with current information on such things as corporate address, business activity and changes in the roster of officers or directors.

Some states charge a franchise tax that must be paid when you file the franchise report. The tax is a fee assessed for doing business in the state. If you fail to file your annual report or franchise tax in a timely fashion, your corporate charter may be revoked, effectively dissolving the corporation.

2. **Keep proper corporate records.**
This includes those required by law as well as documentation of key corporate meetings and transactions. In addition to basic documents, such as articles of incorporation and bylaws, most states require you to maintain a record of the minutes of shareholder meetings and consent resolutions, and all written communications to shareholders within the last three years, including copies of any financial statements furnished to them.

   The IRS and other parties with claims against the corporation may be able to compel disclosure of a much broader range of documents, including detailed financial information, tax returns, sales records, personnel records and company contracts. If you fail to keep appropriate records, a court of the IRS could impose personal liability against individual officers, directors and shareholders of the corporation.

   To maintain your corporation's status as a separate legal entity, important activities should be documented, usually in corporate minutes, contracts or both. If you don't hold the corporation out as a separate legal entity, you make it easier for creditors and other claimants to assert personal liability against you rather than the corporation.

   While corporate minutes don't have to include specific reference to day-to-day business operations, extraordinary items or matters that fall outside the category of daily activity should be expressly noted in the minutes. This would include, for example, decisions relating to the purchase or lease of expensive equipment or real estate, borrowing money or pledging corporate assets as security for a loan, or declaring a dividend or redeeming a corporate stock. Other important transactions can be documented through a bill of sale, invoice, promissory note or contact.

3. **Do not commingle personal assets with business assets or make personal use of business property.**
A corporation should have its own bank account distinct from any personal account you may have. It's much harder to demonstrate that certain expenditures were made for the benefit of the business when personal and business accounts are the same. If personal items are used by the business—tools, office supplies or computer equipment, for example—corporate minutes should document which items are personal.

   Something as simple as personal use of a company-owned car can create potential legal problems. Even if you use the car just to tote the kids back and forth from school, you should document this time for the corporate records. Also, don't try to deduct or depreciate, as business assets, property that is used almost exclusively for personal purposes.

4. **Operate your corporation at arm's length.**
It's common for shareholders, officers and directors of small corporations to enter into business transactions with the corporation. For start-up businesses, corporate loans often come from these individuals. Any such loans should be documented with a corporate resolution or promissory note. Interest rates and repayment provisions should be comparable to those the corporation would have to meet had the lender been a bank or other unrelated party.

   The same rules apply if the corporation is the lender and an officer or shareholder is the borrower, and in cases where shareholders sell or lease assets to the corporation.The temptation to offer favorable terms to individuals associated with the corporation is great, but it must be avoided. "Sweetheart" deals between an individual shareholder, officer or director and the corporation are subject to close scrutiny by the IRS, other shareholders and creditors.

5. **Always identify your business by a corporate name.**
Whenever you do something on behalf of the corporation, make it clear you are not doing business in an individual capacity. If you sign a contract for the corporation, for example, be sure to include your title. Sign as "John Doe, President," and not simply "John Doe." By remembering to use the corporate name and referring to yourself with your corporate capacity, you can insulate yourself from personal liability.

CHAPTER 13

# Control Cash and Credit

What levels of debt can your business safely support? Can you control the amount, timing and availability of credit? That is, can you ensure the timely inflow of cash from new debt?

Assume that you have done all you can realistically to control your cash flow, but you still face occasional periods of cash shortfalls. To tide you over these periods, you have to borrow from an outside source–e.g., a commercial bank or credit-card company line of credit. How do you go about preparing a financing proposal? Begin by focusing on receivables and inventory. Chances are they might be your largest current assets against which you can borrow.

Ideally, receivables and inventory turn into cash as soon as you wish. However, unless you manage them carefully, cash flow and carrying costs become a problem. To manage your working capital properly, you must know:

1. The age of your receivables and inventory.
2. The turn of your receivables and inventory.
3. The concentration of your receivables (how many customers comprise the majority of your receivables, what amount of receivables they represent, what products the receivables cover) and inventory by product lines.

You also must know what your credit and collection policies are doing to your working capital. All too often small business owners mistake sales for profits. They extend more and more credit, pursue lax collection policies and end up financing their customers to increase sales. Most businesses cannot afford to provide interest-free loans to customers just because they expect it. Slow-paying customers must be subject to profitability analysis, which takes into account their carrying costs. Sales increases should translate into profits on the bottom line, but it's difficult to increase profits when you're carrying customers who habitually stretch their payments.

## Five Steps for Managing Receivables

1. Age your receivables.
2. Calculate your collection period and apply the "40-day/30-day" rule of thumb to see if you have a problem.
3. Identify slow-paying customers.
4. Pursue delinquent accounts vigorously.
5. Identify fast-paying accounts and try to increase their number.

**Receivables management.**

To control receivables, begin by examining their age. Break receivables out weekly to spot the slow-pay accounts as soon as possible. Then you can try to collect before the accounts costs you your profits. Aging receivables is simple: Separate invoices into Current, 30 days, 60 days, 90 days and more than 90 days. Then calculate your collection period: Divide annual credit sales by 365 to find the average daily credit sale. Next, divide your current outstanding receivables total by the average daily credit sale. This yields your collection period.

Here's a good rule of thumb for a quick test of your receivables management: If your collection period is more than one third greater than your credit terms (for example, 40 days if your terms are net 30), you have a looming problem.

**Managing your inventory**.

Inventory management, like receivables management, is often overlooked as a source of operating profits. Careful attention to how you manage these two areas can often free up cash and improve operating profits without resorting to bank borrowing. If you are managing both of these areas well, congratulate yourself—you are in a distinct minority.

Carrying costs of inventory can run as high as 30% of average inventory, a substantial drain on working capital. Consider the costs of storage, spoilage, pilferage, inventory loans and insurance. They add up fast.

Determining the right level of inventory to carry is difficult. On the one hand you want to avoid unnecessary expenses, while on the other you want to avoid as many stock-outs as possible. Trying to manage inventory on a day-to-day basis invites trouble; accordingly, most businesses use some kind of inventory policy. The three most important factors in creating an inventory policy are inventory turnover (how many times per year and how that compares with other businesses in the same line), reorder time (planning on a 10-day reorder time is vastly different from a 20-day reorder time) and who your suppliers are.

Inventory control is a balancing act. If your inventory gets too high, you run out of cash. If it's too low, chances are you're buying in uneconomical quantities (a danger sign to bankers), you're too undercapitalized to ever become profitable (another danger sign) or you're bleeding the business.

Bankers are increasingly interested in the quality of inventory as well as the more standard indicators of good management (liquidity, profitability and track record). If you have a cogent inventory policy and follow it carefully, you will upgrade both inventory quality and profitability.

**Establish a contingency plan.**
A contingency plan is a plan you hope never to use. It outlines what you would do if all of your optimistic plans go wrong. It doesn't have to be lengthy. In some cases, it can be as short as a single page and still be more than adequate, although for most businesses such a plan should provide answers to these questions:

1. What suppliers would give you extended terms or carry you in case of a crunch? Why would they carry you? How long and how much?
2. What new investment could you make? Would you refinance personal assets to provide a cash cushion for your business? Could you? What other assets could you bring to support a cash crunch?
3. What assets does your business have to either sell or turn into cash some other way if necessary (perhaps a sale/leaseback, for example)?
4. How will you keep your banker and major trade creditors on your side?
5. Have you examined all possible sources of additional working capital in your business? Where might you have some leverage?
6. What customers would be willing to prepay or speed up orders if it would help you?

The purpose of a contingency plan is to make sure before a crisis occurs that you won't panic. As evidence of thoughtful business management, it's hard to beat and is being sought by more and more creditors.

**Tighten and maintain cash controls.**
Cash flow control begins with the cash flow budget. If you don't have a cash flow budget, you will have cash flow problems. You also need a sales budget or its equivalent to keep the sales level where it should be. Small sales lags can add up to big problems if not spotted early—ranging from a sluggish salesperson to a less than honest clerk.

## Collections

### Follow-Up Form

Name: ____________________

Telephone: ____________________

Spoke to: ____________________

Title: ____________________

Subject: ____________________

Date: ____________________

Time: ____________________

Initials: ____________________

| | |
|---|---|
| ☐ No answer | ☐ Not available |
| ☐ Requested info | ☐ Requested proof of delivery |
| ☐ Order never received | ☐ Payment previously sent |
| ☐ Will send check | ☐ Merchandise returned |
| ☐ Duplicate billing | ☐ Payment being held |

Comments: ____________________

Returned call: ____________________

Follow-up: ____________________

____________________

Your cash flow budget is a good tool for keeping overhead costs down. You have a degree of control over costs that you don't have over sales; while you can almost always cut costs, you can't generate sales (especially cash sales) whenever needed. If you could, you'd never have a cash flow problem.

Every budget has some fat in it. Tightening control means always asking whether this or that purchase or expenditure will have a positive effect on your business. If there is no clear answer, examine the expenditure closely. This effort must be consistent to work. All the controls in the book mean nothing unless they're applied—whether the control is a separation of purchasing from paying, making sure that bills and reorders go out when they should or even keeping a physical count of the inventory.

## Three Credit Policy Steps

1. Divide your customer list into three groups: Prime, Good, Other. *Prime* customers always pay within term; *Good* usually do; *Others* seldom, if ever, do.
2. Look for similarities within the groups. What kinds of customers are Prime or Good? How do they differ from Other?
3. Look for ways to upgrade as many customers as possible to Prime and Good. Remember: You don't have a sale until you're paid.

**Credit and collection.**

The cost of extending credit is one of those hidden costs that eats up working capital. Very few smaller businesses have explicit credit policies. If they did, they could dramatically increase both profits and the quality of their current assets.

Investigate accepting credit cards and encouraging customers to use them. They cost little in return for the headaches they save you. Consider the cost, in direct comparison to bad-debt losses and in time, effort and attention that slow-pay accounts cost you. The added costs of capital tied up in receivables, for example, is frequently greater than any fee charged by the financial institution supporting the transaction.

Use a follow-up form (see page 26 for a sample) each time you call a lagging account. The completed slip will provide back-up information and should be filed for reference on further calls. Remember to ask for specific payments on specific dates. If payment is not received, call back and ask again.

## Speaking About Financial Management

**Accounts payable** — Liabilities resulting from purchases of goods or services on an open-account basis.

**Accounts receivable** — Amounts owed by customers as a result of delivering goods or services and extending credit in the ordinary course of business.

**Balance sheet** — A financial statement that shows a company's assets and liabilities.

**Budget** — A forecast of revenues and expenditures for a specific period of business activity.

**Cash flow** — Usually refers to net cash provided by operating activities; there is also cash flow from financing and investing.

**Cash flow statement** — A report on cash receipts and cash payments for a particular period.

**General ledger** — A record containing the group of accounts that supports the amounts shown in the financial statements.

**Gross profit** — The difference between sales revenue and cost of goods sold.

**Income statement** — A report of all revenues and expenses pertaining to a specific period.

**Inventory turnover** — The number of times during an accounting period that a business sells the value of its inventory. Turnover is calculated by dividing the cost of goods sold by the average inventory during the period. (Average inventory is figured by adding beginning and ending inventory, then dividing by two.)

**Line of credit (LOC)** — An agreement by which a financial institution (usually a bank) holds funds available for a business's use. A secured LOC is ordinarily renewed annually; an unsecured line may have to be paid down once a year.

# Project Your Cash Flow

**Cash Flow** is the movement of cash in and out of your business within a given period, usually a week or a month. It is not the same as profit. A business can show a profit on the day it goes bankrupt—simply because it has insufficient cash to meet its obligations.

**Cash Flow Protection** is looking ahead to determine what your cash flow is likely to be—this is critical to keeping a business running.

**Cash In** and **Cash Out** are the dynamic sections of your cash-flow projection, representing the flow of money in and out of a business. Electronic cash flow worksheets are available at www.score.org.

### Elements of Cash Flow

1. **Starting Cash** (or starting balance)**.** Each monthly projection begins with the amount of cash you have on hand at the start of the month. Your Starting Cash is the same number as the previous month's Ending Cash.

2. **Cash In.** This section of the statement is also called "sources of cash." It includes all cash received during the month. There are several possible sources:

   a. **Sales** are a primary source of cash, but remember to include only cash sales. Sales that have been invoiced do not represent money you can spend this month, so list only the cash sales you expect to have.

   b. **Paid Receivables** are those sales that were previously invoiced and have been paid this month. It is important to project accurately when you expect to be paid—30 days, 60 days, etc. If a sale made in January is actually going to be collected in March, you want your projections to be realistic and reflect that lag time.

   c. **Interest.** When your business is fortunate enough to have money in the bank, it will be earning interest.

   d. **Other.** Additional sources of cash might be a bank loan, sale of stock or the sale of an asset such as a company car.

| | Month 1 |
|---|---|
| **STARTING CASH** | **$2,500** |
| **CASH IN** | |
| **Cash Sales** | **$1,000** |
| **Paid Receivables** | **0** |
| **Other** | **0** |
| **TOTAL CASH IN** | **$1,000** |
| **CASH OUT** | |
| **Rent** | **$700** |
| **Payroll** | **$1,000** |
| **Other** | **$300** |
| **TOTAL CASH OUT** | **$2,000** |
| **ENDING BALANCE** | **$1,500** |
| **CHANGE** | |
| **(Cash Flow)** | **($1,000)** |

3. **Cash Out.** This section is also referred to as "uses of cash." Cash leaves the business in two basic ways: fixed expenses and variable expenses.

   a. **Fixed Expenses** are incurred regularly and are not easily eliminated. Generally, they do not fluctuate with sales volume; they are "fixed" from month to month: rent and payroll, payroll taxes, estimated taxes, utilities, interest on loans and insurance payments.

   b. **Variable Expenses** can change from month to month and often vary with sales volume or production volume. They can be more easily changed than fixed expenses. Some examples: supplies, commissions, advertising, raw materials, consulting services and promotion.

4. **Ending Cash** (or Ending Balance) is how much cash is left at the end of the month. It is the result of the numbers in Cash In and Cash Out. Simply add the Starting Cash to Total Cash In and then subtract Total Cash Out. The cash you end the month with is the cash you have to start the next month—so, you get the number for Starting Cash by copying if from the previous month's Ending Cash.

5. **Cash Flow** is the amount that has flowed through the business (see box below). It is a measure of what has happened that month. If nothing has happened—say you began with $1,000 and didn't take any cash in or pay out a nickel—you would end up with $1,000, but your Cash Flow would be $0. To calculate Cash Flow, subtract the Ending Cash from the Starting Cash. The secret to success is positive cash flow.

## Quarterly Cash Flow Worksheet (by Month)

| MONTH: | | | |
|---|---|---|---|
| **STARTING CASH** | | | |
| **CASH IN** | | | |
| **Cash Sales** | | | |
| **Paid Receivables** | | | |
| | | | |
| | | | |
| | | | |
| **TOTAL CASH IN** | | | |
| **CASH OUT** | | | |
| **Rent** | | | |
| **Payroll** | | | |
| | | | |
| | | | |
| | | | |
| | | | |
| **TOTAL CASH OUT** | | | |
| **ENDING CASH** | | | |
| **CHANGE** | | | |
| **(Cash Flow)** | | | |

CHAPTER 14

# Chart Your Business Progress

Once you're open for business, how should you monitor your company's health and progress? Besides sales and profits, what other indicators will help you measure performance? And how often should you track those measurements?

As your company grows, it will be in a constant state of flux, with hundreds of variables at play each day. Each of them will have a pull on you and your employees, dictating behavior and priorities. But at the end of the day, which variables will really count? One of the most significant management tools for growing a company is the development of a clear set of performance indicators that represent the criteria from which the business is managed and monitored. These critical numbers are most often associated with financial performance—sales, margins and accounts receivables. But other important aspects of your business also impact overall performance, such as customer-service ratings, inventory, number of complaints, quality statistics, employee morale and satisfaction ratings, sales figures and collections.

To ensure your success as a new business owner, make a list of the factors that are most important to your company's performance and then select a group of key indicators to track on a regular basis. Choose those factors that are critical to sustaining your company's competitive advantage as well as maintaining its general health.

The tracking reports to which you refer most often should be kept short and, therefore, user-friendly. For instance, you probably should only track three of four key indicators—at most—on a daily basis. They should be the ones that can have the most significant impact on your business. A more detailed report may be more appropriate for weekly or monthly review.

Areas to consider for performance measures include:

- Sales growth (number of calls, close rations, etc.)
- Cash management (accounts receivable/payable, cash balances, inventory levels, future projections)
- Profit measures (key drivers of profitability)
- Customer feedback scores (e.g., service ratings)
- Employee feedback scores (periodic surveys measuring morale, commitment, communication, etc.)

The development of performance measurements is one of the most important keys to long-term growth. It will facilitate management control and communication throughout your company and it will support your efforts to perform at the highest level. Once successfully launched and in business, re-evaluate your need to incorporate or form an LLC to protect yourself and your family.

Get helpful business planning tools and templates on the SCORE Business Plans & Financial Statements Template Gallery (www.score.org/resources/business-plans-financial-statements-template-gallery).

## Why Are You in Business?

You and your employees should be able to articulate the true mission of your company and hence, its critical-success factors. Here are eight questions that will help you define your company's core purpose:

1. What makes us different from our competitors?
2. Why do customers buy from us rather than from our competitors?
3. What are our best talents and strengths?
4. What are we most proud of?
5. What does our company do that others would want to benchmark?
6. How do we make life better for our customers?
7. How do we create competitive advantages for our customers?
8. What do we want our reputation to be?

## How to Take Your Company's Pulse

Which numbers should you keep an eye on to monitor your business's financial health—and how often should you check them? Here are 10 critical checkpoints:

**Weekly Updates**

1. Current cash position (how much cash was received, when and from whom)
2. Cash disbursements (e.g., payroll, materials and purchasing)
3. New sales
4. Accounts receivable (beginning balances, outstanding credit and cash receivables)
5. Accounts-payable payments
6. Order backlog
7. Number of employees (with a productivity metric; e.g., sales per employee)

**Monthly Updates**

8. Inventory (with accounting or physical tests of accuracy)
9. Accounts-receivable average days outstanding
10. Accounts-payable obligations (with aging breakdown)

# The Company Corporation®

## Incorporating What's Right For You

With more than half a million businesses formed, The Company Corporation provides affordable incorporation services to small businesses and entrepreneurs nationwide.

In addition to helping form corporations and limited liability companies (LLCs) in all 50 states and the District of Columbia, The Company Corporation offers a wide range of products and services, including license and permit assistance, corporate kits, business education books, corporate filing services, certificates of good standing, Registered Agent services, and business start-up services.

As part of our commitment to America's small business owners, The Company Corporation supports the SCORE organization and provides educational materials for use by SCORE mentors and clients.

For more information about incorporating or forming an LLC, please visit our website at **www.incorporate.com/score** or speak with one of our Business Specialists at **866-544-6804** (toll-free).

*The Company Corporation is a service company and does not provide legal or financial advice*



# SCORE

## For The Life Of Your Business

SCORE is a nonprofit association dedicated to educating entrepreneurs and mentoring small business owners during all stages of business development including formation, growth, and beyond.

Founded in 1964 and serving as a resource partner with the U.S. Small Business Administration, the SCORE association has helped more than 10 million entrepreneurs build, expand, and protect their small businesses. SCORE provides information, advice, and interactive workshops on topics such as business start-up, financing, marketing, and technology.

SCORE mentors work directly with entrepreneurs to meet the needs of their small business as they continually evolve. More than 12,000 SCORE business mentors in over 340 chapters nationwide volunteer their time and expertise to provide free and confidential small business guidance. SCORE mentors are active and retired business owners and executives, with extensive experience in a wide spectrum of fields.

For *free and confidential* assistance, contact your local SCORE office or get assistance online at **www.score.org**. To find an office near you or obtain more information on our business workshops, call **800-634-0245**.

IN COOPERATION WITH

SCORE

FOR THE LIFE OF YOUR BUSINESS

www.score.org
800-634-0245

SPONSORED BY

THE COMPANY CORPORATION®

www.incorporate.com/score

866-544-6804 (toll free)

Congratulations on your decision to live your dream. This workbook is brought to you by SCORE and The Company Corporation as a guide for your success.