Strategic Business Solutions, Inc. is your source for strategic business planning. Staffed by experienced business professionals, Strategic Business Solutions, Inc. works closely with your legal and accounting team to help you develop and implement business and strategic plans designed to take your business to the next level.

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# Table of Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Introduction</td>
<td>1</td>
</tr>
<tr>
<td>Executive Summary</td>
<td>2</td>
</tr>
<tr>
<td>Assumptions</td>
<td>3</td>
</tr>
<tr>
<td>Core Competencies</td>
<td>4</td>
</tr>
<tr>
<td>Mission Statement</td>
<td>5</td>
</tr>
<tr>
<td>Products &amp; Services</td>
<td>7</td>
</tr>
<tr>
<td>Organizational Chart</td>
<td>8</td>
</tr>
<tr>
<td>Start-up Costs</td>
<td>10</td>
</tr>
<tr>
<td>Estimating Capital Needs</td>
<td>13</td>
</tr>
<tr>
<td>1. Percent of Sales Method</td>
<td>13</td>
</tr>
<tr>
<td>2. Cash Budget Method</td>
<td>13</td>
</tr>
<tr>
<td>3. Cash Turnover Method</td>
<td>14</td>
</tr>
<tr>
<td>Competitive Advantage</td>
<td>15</td>
</tr>
<tr>
<td>Market Analysis</td>
<td>17</td>
</tr>
<tr>
<td>Barriers to Entry</td>
<td>20</td>
</tr>
<tr>
<td>Structure of Business</td>
<td>21</td>
</tr>
<tr>
<td>1. Corporation</td>
<td>21</td>
</tr>
<tr>
<td>a. C Corporation</td>
<td>21</td>
</tr>
<tr>
<td>b. S Corporation</td>
<td>21</td>
</tr>
<tr>
<td>2. Limited Liability Company (LLC)</td>
<td>22</td>
</tr>
<tr>
<td>3. Partnership</td>
<td>22</td>
</tr>
<tr>
<td>a. Limited Partnership</td>
<td>22</td>
</tr>
<tr>
<td>b. General Partnership</td>
<td>22</td>
</tr>
<tr>
<td>4. Sole Proprietorship</td>
<td>22</td>
</tr>
<tr>
<td>Operations</td>
<td>23</td>
</tr>
<tr>
<td>Taxes</td>
<td>24</td>
</tr>
<tr>
<td>1. City, State and Federal Income Tax</td>
<td>24</td>
</tr>
<tr>
<td>2. Self Employment Tax</td>
<td>24</td>
</tr>
<tr>
<td>3. State and Federal Payroll Taxes</td>
<td>24</td>
</tr>
<tr>
<td>4. Sales and Use Tax</td>
<td>25</td>
</tr>
<tr>
<td>5. Real Property Tax</td>
<td>26</td>
</tr>
<tr>
<td>6. Unsecured Personal Property Tax</td>
<td>26</td>
</tr>
</tbody>
</table>
7.  Vehicle Tax.................................................................. Page -26-
8.  Special Tax.................................................................. Page -26-
9.  Business Tax.................................................................. Page -27-
10.  Where to include Taxes on your Financial Statements........ Page -27-

Sales Forecast.................................................................. Page -28-

Employees........................................................................ Page -33-

Competitive Analysis.......................................................... Page -34-

Target Market..................................................................... Page -39-

Marketing Plan................................................................. Page -41-

SWOT Analysis................................................................... Page -44-

Insurance............................................................................ Page -47-

Industry Analysis.............................................................. Page -49-

Preparing the Financial Statements........................................ Page -54-
  1.  Depreciation............................................................... Page -54-
  2.  Cost of Goods Sold...................................................... Page -55-
  3.  Income Statement........................................................ Page -56-
  4.  Statement of Owner’s Equity......................................... Page -57-
  5.  Cash Flow Statement..................................................... Page -58-
  6.  Balance Sheet.............................................................. Page -59-
  7.  Loan Amortization......................................................... Page -61-

Break-Even Analysis.......................................................... Page -63-

Ratio Analysis.................................................................... Page -66-
  1.  Liquidity Ratios............................................................ Page -66-
      a.  Current Ratio......................................................... Page -66-
      b.  Quick Ratio (Acid Test)........................................... Page -66-
      c.  Turnover of Cash Ratio.......................................... Page -66-
      d.  Debt to Equity Ratio............................................... Page -67-
  2.  Profitability Ratios......................................................... Page -67-
      a.  Rate of Return on Sales.......................................... Page -67-
      b.  Rate of Return on Assets....................................... Page -67-
      c.  Rate of Return on Investments............................... Page -67-
  3.  Efficiency Ratios............................................................ Page -68-
      a.  Average Collection Period Ratio............................ Page -68-
      b.  Inventory Turnover Ratio...................................... Page -68-
      c.  Fixed Asset Turnover Ratio.................................... Page -68-
  4.  Other Profitability Measures........................................ Page -68-
      a.  Average Rate of Return (ARR)................................ Page -68-
      b.  Payback Period..................................................... Page -69-
      c.  Net Present Value (NPV)........................................ Page -70-
Business plans may be prepared for a variety of reasons. Most typically, business plans will be developed to facilitate financing, operational, or strategic goals.

Business plans written primarily for financing purposes tend to be the most common. These plans have as their primary goal obtaining capital from lenders or investors. These plans will tend to be quite formal and will stress financial issues. Moreover, as these business plans are written primarily for outsiders, the plan must assume the reader has little or no knowledge of the business.

Operational business plans tend to be written for an internal audience, and help define the functional aspects of the business. These plans will be more focused on internal operations to give direction to team members a clear picture as to the functional dynamics of the business. As the plan is geared toward insiders of the business, it will tend to assume basic knowledge of the business itself.

Strategic business plans are often written for entrepreneur, him/herself, and allows the entrepreneur a vehicle by which he/she may organize thoughts and ideas so as to develop a strategic plan for the business.
Executive Summary

The executive summary is perhaps the most important section of the business plan. Your summary should be concise and specific. It will summarize the highlights of your business plan, and should include sales, spending, and profit summary figures. The summary should emphasize all factors which make your business successful. The summary should include precise numbers for the size of your market as well as its trends, your company’s goals, income and spending information, ROI, and required funding.

The executive summary should include the following:

1. Description of the business
2. What are the company objectives?
   a. These should be stated in specific terms
3. Description of products and services
   a. Identify any intellectual property issues
   b. Can you effectively price the product and still maintain a healthy profit margin?
4. Describe your target market and why they need or want your product or service
   a. Include market research data
   b. Include an explanation of market demand for your product or service
   c. What percentage of market share do you project attaining?
   d. What is the growth potential of the market? Provide supporting documentation
   e. Will your share of the market increase or decrease as the market grows?
   f. How will you satisfy market growth?
   g. How will your price your goods or services to remain competitive in a growing market?
5. Customers
   a. If you have existing clientele, identify them
   b. If your business is new, describe your market potential in specific terms
   c. Identify in specifics your customers’ buying habits
6. Competitive advantage
7. Key management
   a. Identify your key personnel and how they will contribute to the success of the business
8. Financials and funding requirements
   a. project revenues based on projected market share
   b. give a timeline for profitability
   c. give a brief description of your cash flow and balance sheet
Assumptions

The validity of your business plan will rest on the assumptions you make. Your business plan is based on a variety of assumptions. Some of them are so basic that they will be unstated. For example, your primary assumption will be that life will continue as usual, rather than be beset by some cataclysmic event. Beyond the most basic assumptions, though, you should identify the assumptions you will be making.

Some of the broadest types of assumptions you will be making in your business plan include:

1. The General business climate. These will include issues such as interest rates, demographics, and other factors commonly faced by businesses.

2. Business specific assumptions. These will be tailored to your business and will include specific capabilities that your business must develop or maintain.

3. Alternate assumptions. These will explain your contingency plans in response to events outside your control.
Core Competencies

Core competencies of your business refer to those qualities or skills you have which you do well. These are not defined relative to your competitors. Indeed, your core competencies might not be superior to those of your competitors, when compared. These core competencies will be used to help you develop your SWOT Analysis, and will be used in your strategic planning. The goal is to take your core competencies and use them to develop a competitive advantage.

A new business should first attempt to identify its core competencies. Once identified, the business can use these as a focus for its reputation and brand recognition. Ultimately, these core competencies should allow a company to differentiate itself from its competitors.

When identifying core competencies, one must ask why customers choose one product as opposed to another. Questions such as: “why is the customer willing to pay more or less for one product or service than another?” “What is a customer actually paying for?” are critical in defining core competencies.

A hallmark of core competencies is that it is a skill or ability that is difficult to imitate. A skill or ability that is commonplace, or a prerequisite in the industry cannot be considered a core competency because it does not provide any differentiation for the business and will not form the basis of competitive advantage.

Further, core competencies will evolve over time. As a business evolves and adapts to changing market factors, its core competencies must also be flexible enough to adapt and change.
Mission Statement

Your company’s mission statement should be a clear and concise representation of the company’s raison d’être.

The mission statement should explain the company’s nature, its values, and its work and will include these qualities:

1. It is based on your competitive advantage and core competencies.
2. It must be realistic – not too broad, and not too narrow.
3. It should be specific, short, and focused

To develop a mission statement, ask yourself these questions:

1. What need do we exist to address? ________________

2. How are we going to achieve those needs? ________________

3. What are our principles? ________________

Examples of Mission Statements:

A mission statement for a discount retail store in the US: “We deliver value through low prices to middle Americans.”

University of Phoenix: The mission of University of Phoenix is to educate working adults to develop the knowledge and skills that will enable them to achieve their professional goals, improve the productivity of their organizations, and provide leadership and service to their communities.

Hershey Foods: Our mission is to be a focused food company in North America, and selected international markets, and a leader in every aspect of our business. Our goal is to enhance our #1 position in the North American confectionery market, to be the leader in U.S. chocolate-related grocery products, and to build leadership positions in selected international markets.

CVS – Retail: Our company’s vision is to help people live longer, healthier and happier lives. An integral part of this vision is our investment in the communities we serve. The primary focus of our programs is health and education, two natural extensions of our company’s goals.

EQUIFAX – Business Services: To serve our customers by utilizing information and technology that provide real-time answers to increasingly complex questions.
Rotary International: The mission of Rotary International is to support its member clubs in fulfilling the Object of Rotary by:

- Fostering unity among member clubs
- Strengthening and expanding Rotary around the world
- Communicating worldwide the work of Rotary
- Providing a system of international administration.

Resources:

http://www.missionstatements.com

http://mystrategicplan.com
Products & Services

You should be specifically define what you are selling. Be sure to articulate and emphasize customer benefits. This section should include details about your suppliers and corresponding costs. Further, you should define the net revenue you expect from the sale of these products or services. You may wish to enhance this section with pictures and/or diagrams. This section should include:

1. A detailed description of your products or services with emphasis on their benefits. Pictures are helpful in communicating concisely what products you are offering.

2. Explain your product’s or service’s place in the market, with an explanation as to its advantages over the competition. This will include:

   a. What is the product or service’s life cycle?

   b. Are there intellectual property rights, such as copyright, patent or trade secrets?

   c. What r&d is the company undertaking which may lead to new products or services, or which will maintain your product’s or service’s position in the forefront of the market?
Organizational Chart

The organization chart is the graph of your company's organizational structure. It should identify the company owners, management team and board of directors. In a small to medium firm, it will probably include all the employees. In a large firm, it will typically show management structure.

The organizational chart should show the relationship among the individuals. Vertical lines connecting members of the organization show the hierarchical relationship, and horizontal lines demonstrate that the individuals are of equal hierarchical standing.

Sample Organization Chart

In addition to the organizational chart as a graphic, the written business plan should include specific information about management and employees. This information should include:

1. Descriptions of departments and key employees (if a large company) and all employees if small to medium.

2. Information about owners, including their names, percentage of ownership, extent of involvement within the company and a biography listing their background and skills.

3. Description of the management team, including names and positions. Information should include:
   a. business experience of the management team
   b. other past experience
   c. educational background
d. personal financial statements of the principals, including supporting documentation

e. A clear description of duties and responsibilities, including who is responsible for final decisions.

f. Identify compensation packages, including benefits

4. Description of board members.

5. Personnel. You should identify the following information about your employees:

a. What are your current personnel needs, and will they be full time or part time?

b. How many employees will you need during the time period covered by your business plan?

c. What skills must they have?

d. What are their job descriptions?

e. Are there people readily available, and if not, how will you recruit?

f. What and how will you pay your employees?

g. What benefits will you offer?
Start-up Costs

Start-up costs are one-time costs which are required to get the business going. Start-up costs should be estimated on a separate worksheet. They should not be included in the first year’s profit & loss statement because these are not recurring costs.

The first step is to identify start-up cost categories. These categories may include:

LEGAL
copyrights
trademarks
retainers
incorporation fees
fictitious business name
advertise dba
business license
seller’s permit
accountant
lawyer
others
health license
liquor license
ABC fee
county/city fees

RESEARCH & DEVELOPMENT
patents
prototypes
product testing
test marketing
salaries
materials
marketing research

FURNITURE, FIXTURES & EQUIPMENT
cash registers
cleaning equipment - vacuum, mops/buckets, floor polisher, etc.
communications - computers, fax, telephone system, answering machine, modem
trucks
benches, tables, chairs, desks
shelving, cabinets
file cabinets
copy machine
microwave, refrigerator, coffee maker
computers and printers
time clock
window displays
LAND & BUILDING
  plans
  permits
  construction
  mortgage - down payments, fees
  property taxes/triple net
  lease

REMODELING & IMPROVEMENTS
  parking lots
  alarm system
  sprinkler system, fire doors
  landscaping
  water, electrical, lighting
  restrooms/handicap
  heat, ventilation, air (HVAC)
  installation fees
  floor, wallpaper
  curtains, pictures, decorations

PREPAIDS & DEPOSITS
  rent
  taxes
  insurance
  credit with suppliers
  public utility deposits

INVENTORY
  investment in inventory
  delivery
  storage
  insurance
  special packing

PERSONNEL
  worker's compensation deposit
  worker's compensation insurance
  training, seminars, workshops
  1-2 weeks practice, on the job training
  set up costs and wages
  recruitment costs
  retainers

CASH
  cash flow reserve - 1-3 months operating expenses
  cash register drawers
  petty cash fund
  minimum balance in checking
cash collateral used for loan
working capital

LIVING EXPENSES
estimate # of months without income

CONTINGENCY FUNDS
1-3 months operating expenses
emergency fund

OTHERS
pre-opening advertising
security
office supplies
signs
insurance (see worksheet)
telephone system
moving/relocation - personal or business
graphic artist - ads, logos, business cards, others?

You will have to conduct research on your industry to determine what costs there will be.

You can conduct interviews with people already in the industry.

You can research through trade associations.

You can research franchise information.
When calculating your start-up costs, you must also consider how much capital will be invested in the business. How does one determine what is an appropriate capital investment? There are multiple methods by which one may calculate appropriate financing.

1. Percent of Sales Method

This method assumes that changes in sales affect the amount of assets to be maintained in a company. An asset that changes as a result of increases or decreases in sales is called a spontaneous asset. If sales are expected to rise, the company needs more cash and inventory and should expect more accounts receivable to accumulate. If sales are predicted to decline, inventory levels should be reduced. To accommodate growth in sales and concomitant increase in the need of spontaneous assets, external financing may be required.

The amount of required external financing can be calculated by

\[
\text{External Required Financing} = \left( \frac{\text{Spontaneous Assets}}{\text{Sales}} \right) \cdot (\text{Expected change in sales}) - \left( \frac{\text{Liabilities}}{\text{Sales}} \right) \cdot (\text{Expected change in sales}) - \left( \frac{\text{Net profits after dividends}}{\text{Sales}} \right) \cdot \text{Sales}
\]

**EXAMPLE:** The historical ratio of assets that spontaneously change with sales is 70%. The ratio for liabilities is 30%. Sales are expected to increase by $200,000 in the next year. The company has historically 3% of its sales revenue as net earnings after dividends. Assume expected sales are $1,000,000, predict the amount of external required financing for the next year.

\[
\text{External Required Financing} = 70\% \cdot 200,000 - 30\% \cdot 200,000 - 3\% \cdot 1,000,000 = 140,000 - 60,000 - 30,000 = \$50,000
\]

Therefore, we know we need a capital infusion of $50,000 to accommodate the growth in sales.

2. Cash Budget Method

The purpose of liquidity management is to ensure that the company will never run out of cash. The cash budget technique may be used to achieve this objective. Compare future cash receipts with future cash payments on a monthly basis and determine the financing surplus or deficit for each month. Net monthly cash flow is determined by subtracting estimated payments from estimated receipts. Then add the cash at the beginning of the period to the net cash flow to get the end cash. Figure the minimum amount of cash that a company should maintain to avoid running out of cash. Adding the minimum reserve to the end cash gives the estimated cash surplus or deficit. The company must plan in advance how to cover the deficit. Despite substantial earnings, a company may run into cash deficit problems if a/r are not properly collected.
3. Cash Turnover Method

The minimum amount of cash needed by a company to run its operation is determined by the use of the following equation: \( \text{Minimum cash required} = \frac{\text{annual operating expenditures}}{\text{cash turnover}} \)

This assumes that there are no significant changes in operating expenditures from one period to another. Cash turnover is the number of times that a firm’s cash is collected, or turned over, in a year. Cash turnover is calculated as follows: \( \text{Cash turnover} = \frac{360 \text{ days}}{\text{days between purchase of materials and collection of sales proceeds}} \)

**EXAMPLE:** Assume the cash cycle is 72 days and annual expenditures are $600,000. Cash turnover = \( \frac{360}{72} = 5 \). Minimum cash required = \( \frac{600,000}{5} = $120,000 \)
As part of the business plan, you must identify what your competitive advantage is. To help clarify your competitive advantage, you may want to ask yourself the following:

**Passion**
What is your organization deeply passionate about?

**Purpose**
What is the purpose of your business? Why does your business exist?

**Resource**
What unique skills (not a person), resources, capabilities, and assets set our company apart in the marketplace?
Can these skills and resources be used to create value in the marketplace? If yes, how are these skills and resources used now to create value? If no, what can we do?
What is our company best at relative to our competitors? What can we be best at in the market?

**Profit Engine**
What is our primary revenue driver? How do we make money? (i.e. profit per customers, profit per customer visits, profit per employee, profit per order)

How sustainable is your Competitive Advantage?
In other words, is it difficult for competitors to match your competitive advantage?
Can you improve your competitive advantage?

Competitive Advantage can be achieved through a variety of means

1. **Competitive Advantage through Philanthropy**
   Corporate philanthropy is often used as advertising in order to promote the company image and increase its visibility. It can also be used, though, to create a social impact which may improve competitiveness. By directing philanthropy to enhance education and training, local quality of life and the quality of supporting industries in the area, a company can improve the pool of labor and capital from which to draw and thereby improve its own competitiveness.

2. **Competitive Advantage through Superior Performance**
   By implementing market-oriented behaviors, a company may better focus on the customer wants and needs than its competitors. This involves implementing market intelligence gathering methods to determine current and future customer wants, and then communicating this information across the organization. With the information disseminated, the organization must then focus on responding to these needs and wants.
3. Develop Strategic Plan to Identify and Sustain Competitive Advantage

Your company’s strategic plan should be formulated which not only identifies competitive advantage, but promotes sustainable competitive advantage. The strategic plan must be specific, clearly articulated to all departments within the organization, contain achievable goals, and identify some method of measuring the success of the plan.

<table>
<thead>
<tr>
<th>STEPS IN STRATEGIC PLANNING</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Step #1</strong></td>
</tr>
<tr>
<td>Develop Mission &amp; Vision Statement</td>
</tr>
<tr>
<td>Core competencies</td>
</tr>
<tr>
<td>(Direction, umbrella statement, Mission-Present Purpose, Vision-Future Picture) (Scope of operation)</td>
</tr>
<tr>
<td><strong>Step #6</strong></td>
</tr>
<tr>
<td>Strategy Formulation</td>
</tr>
<tr>
<td>Positioning</td>
</tr>
<tr>
<td>(Overall action plans, how to get there)</td>
</tr>
</tbody>
</table>

4. Elements of Competitive Advantage

a. **Consistent Difference**: Customers must see a consistent difference between your product/service and those of your competitors. This difference needs to be obvious to your customers and it must influence their purchasing decision.

b. **Difficult to Duplicate**: Your competitive advantage must be difficult to duplicate. This may be derived from proprietary knowledge or processes.

5. Competitive Advantage as an Element of Marketing

Your marketing plan should highlight your competitive advantage. Turn it into a tagline. Use it in a press release. Add it to your corporate About Us page on your website.

Regularly communicate your competitive advantage both internally and externally. Continually refine your competitive advantage through internal and external feedback.
Market Analysis

The market analysis presents your conclusions regarding external market factors that will affect your business. It examines the totality of the business environment in which you will compete.

Your market analysis should include the existence and type of competitors, a description of your target customers, the market size, distribution costs, and trends in both your industry and the market. The purpose of the market analysis is to lay the groundwork for your marketing strategy.

Your market analysis should contain specifics. Identify the size of your market. Is it large enough to sustain both your business and the competition? What is the growth trend for the next five years?

Identify specifically the market segment to whom you will be selling. Your actual market segment may be only a small fraction of the total market. To identify your market clearly, you should identify
- the size of the total market
- the size of the market that is interested in your products
- the size of the market to whom you can distribute
- the size of the market that already buys competitive products
- the size of the market that your company can serve
- the size of the market that your company can reach with advertising and distribution

One of the most common mistakes business owners will make is not clearly identifying their market. For example, the market for your Indian restaurant is not everyone who eats food. More likely, your market will be people within a specific zip code, perhaps of a specific ethnicity, perhaps of a specific income level, perhaps of a specific age, and perhaps who are amenable to ethnic food. Not only must you identify your most likely customers, but then you must attempt to quantify the number of people who constitute that group.

Research:

For California specific information, the California Department of Finance (http://www.dof.ca.gov/HTML/FS_DATA/profiles/pf_home.php) can give you valuable statistics. This site can give you county profiles, including population, education, employment rates, etc. This site also carries demographic data regarding race/ethnicity, gender, and age for California counties, including historical data as well as projections.
Bureau of Economic Analysis can be a treasure trove of information. [http://www.bea.gov](http://www.bea.gov). You can access regional, national, or international statistical data.

You can obtain GDP for state and metropolitan areas. You can access personal income by major source and earnings by NAICS industry. You can obtain information about consumer spending.
The Census Bureau provides a multitude of statistical and demographic information:

**Lifestyle Market Analyst**

**Demographics USA County or Zip Code editions**

Bureau of the Census at [http://www.census.gov](http://www.census.gov)


EASI gives estimated demographic statistics, available for purchase, within a specific radius of any address at [http://www.easidemographics.com](http://www.easidemographics.com)

Psychographic information can be found at [http://www.claritas.com](http://www.claritas.com)

Barriers to Entry

Barriers to entry are the costs and/or requirements needed to enter a market. They protect companies already in business by making it more difficult for others to enter.

Not every business will have barriers to entry, and if your business does not have any, you should be honest and say that. However, when few barriers to entry exist, if your business plan shows substantial profit, you must be prepared to explain why others are not jumping into the market to compete against you and command some of your market share.

Indeed, the threats of new entrants to the market is greatest, and, consequently, the barriers to entry are lowest, when:

- processes are not protected by regulations or patents
- customers have little brand loyalty
- start-up costs are low
- products provided are not unique
- switching costs (incurred by the consumer) are low
- production process is easily learned
- access to inputs is easy
- access to customers is easy
- economies of scale are minimal

In addition to new enterprises, the emergence of a new competitor may encourage already existing companies to react to try to discourage the new competitor. Such retaliation could include lowering prices or forming partnerships. When firms have a history of retaliation, are committed to the industry or where the industry has slow growth, the chance of retaliation is high.

Barriers to entry could include regulatory considerations. For example, a regulation requiring a three year wait before goods could be labeled organic would constitute a barrier to entry. Furthermore, potential regulation, while not a current barrier to entry, would constitute a threat and would need to be identified in your SWOT analysis. Your research should include, then, not only existing barriers, but also news reports related to your industry so that you can identify potential threats and possible new barriers to entry.
Structure of Business

Your business may be structured in a variety of ways. Your choice of business structure must be thoroughly researched and explained. Common structures of business in the United States are as follows:

1. Corporation

A California corporation is a legal entity which exists separately from its owners. While normally limiting the owners from personal liability, taxes are levied on the corporation as well as on the shareholders. The sale of stocks or bonds can generate additional capital and the longevity of the corporation can continue past the death of the owners. To form a corporation in California, Articles of Incorporation must be filed with the California Secretary of State.

Corporations offer the advantage of personal liability protection to its shareholders. In addition, it may offer tax savings. Conversely, some businesses may find that operating as a corporation actually increases their tax burdens. Research on your individual industry, using your specific sales projections will help you determine whether or not a corporation is advantageous for you from a tax standpoint. Corporations may make obtaining financing easier, and may be required by some customers prior to their doing business with you.

Corporations will generally cost more to set up and maintain than a sole proprietorship.

There are two kinds of corporations: S and C. These are so named for the relevant section of the tax code.

a. C Corporation

A C corporation can have one or more owner. All corporations are C corporations by default. A special election must be submitted to the IRS to be treated as an S corporation. There are no restrictions on the type or number of shareholders a C corporation may have. In addition, a C corporation may choose to have a fiscal year that is not the calendar year.

It is said that C corporations result in double taxation. While this does not necessarily mean more tax will be paid as a result, it does mean that the business will be taxed on two levels: the corporate level and the individual level.

b. S Corporation

The S Corporation is often favored by small businesses. It is considered a pass-through entity, which means that the income of the corporation passes through the corporation, and is attributed to the individual owners who will pay individual taxes based on their share of the corporate income or loss. The S Corporation enjoys all the liability protection of a C corporation, but is restricted in the number and type of individuals who can be shareholders. In addition, an S corporation will only have one class of stock:
common stock, and will have a calendar year fiscal year.

2. Limited Liability Company (LLC)

A California LLC offers liability protection similar to that of a corporation but is taxed differently. An LLC may be formed by one or more members. If the LLC is a single member LLC, it is considered a disregarded entity for income tax purposes, and therefore, the sole member of the LLC will pay income taxes as though s/he were a sole proprietor. LLCs with at least two members can choose to be taxed either as a corporation or as a partnership.

Not all businesses are permitted to form LLCs. For example, businesses requiring a professional license will typically be barred from forming an LLC.

3. Partnership

Partnerships may be formed by two or more partners. Partnerships offer no liability protection for their general partners, thereby increasing risk to the individual business owners. Partnerships will apportion profit or loss amongst the partners pursuant to their individual partnership share, and the individual partners will pay income tax based on their portion of the profit or loss of the business.

The two major types of partnerships are the general partnership and the limited partnership.

a. Limited Partnership

A California LP may provide limited liability for some partners. There must be at least one general partner that acts as the controlling partner and one limited partner whose liability is normally limited to the amount of control or participation of the limited partner. General partners of an LP have unlimited personal liability for the LP's debts and obligation, but have the ability to control the partnership. The limited partners have limited liability for the partnership's obligations and debts, but have no ability to manage or control the partnership.

b. General Partnership

A California GP must have two or more persons engaged in a business for profit. Except as otherwise provided by law, all partners are liable jointly and severally for all obligations of the partnership unless agreed by the claimant. Profits are taxed as personal income for the partners.

4. Sole Proprietorship

A sole proprietorship assumes a single business owner. It is easy and cheap to establish, but carries with it significant risk, as the sole proprietor is individually liable for all business debts.
Operations

You should describe how your business will be run. This section will include the following information:

1. Will you be undertaking research and development?

2. What products or services do you need to acquire in order to produce, supply or develop your product or service?
   a. Which vendors will you need?
   b. Do you have current vendor relationships?
   c. If not, who will you choose and why?

3. What staffing requirements will be needed for daily operations?

4. What equipment will you require?

5. Identify and describe your facilities requirements
Taxes

If you are going to be in business, you'll want to know what types of business taxes may apply, including:

- City, State and Federal Income Tax
- Self-Employment Tax
- State and Federal Payroll
- Sales and Use Tax
- Real Property Tax
- Unsecured Property Tax
- Special Tax
- Business Tax

1. City, State and Federal Income Tax

This is a tax on you and/or your business's net income. If your business entity is a sole proprietorship, or you have a net profit reported on your individual income tax return from a partnership or S corporation, you pay any California or federal income tax liability by making quarterly estimated tax payments. These estimated tax payments apply to your individual income tax returns FTB Form 540 and IRS Form 1040. For more information about estimated taxes see IRS Publication 505, Tax Withholding and Estimated Tax.

If your business is a corporation, or a limited liability company structured as a corporation, the quarterly estimated tax payments are made by the business and apply to the business's corporate FTB Form 100 and IRS Form 1120. The IRS provides more information about this in IRS Publication 542, Corporations.

Please note that some cities impose an income tax on their residents, and each state has its own tax laws as well. You must determine the specific laws regulating your location.

2. Self Employment Tax

Self-employment tax is social security and Medicare tax for people who are self-employed. This tax applies to those who are sole proprietors with a net profit of $400 or more during the year. It also applies to individuals who have a net profit of $400 or more during the year from the partnership or limited liability company that is structured as a partnership.

3. State and Federal Payroll Taxes

California employers are required to report all employee wages to the EDD each calendar quarter. With the exception of some employers of household workers, periodic deposits of State Disability Insurance (SDI) and Personal Income Tax (PIT) withholdings are required. The frequency of the employer's deposit schedule is determined by the employer's federal deposit schedule and the amount of PIT withheld. An annual reconciliation of state income tax withholding is also required.

New employers in California pay 3.4% of the first $7,000 in wages per employee for Unemployment Insurance (UI) tax and 0.1% (also of the first $7,000 in wages) for Employment Training
Tax (ETT). While the UI rate for new employers doesn't change for the first three tax years, the ETT rate may be 0% (zero) for a new employer after his first year if his reserve account has a negative balance. See DE 231Z, Information Sheet: California System of Experience Rating for information on how UI rates are determined. The SDI rate may change each year.

In addition to withholding and depositing federal income tax, social security, and Medicare taxes from an employee's wages, employers are responsible for withholding and paying a matching amount for social security and Medicare taxes. For more information on this, see Section 9, Withholding From Employee's Wages, of IRS Publication 15, Employer's Tax Guide.

Publication 15 (Circular E), Employer's Tax Guide, explains your federal tax responsibilities as an employer. It explains the requirements for withholding, depositing, reporting, and paying federal employment taxes. It explains the federal forms you must give your employees, those your employees must give you, and those you must send to the IRS and SSA.

Additional employment tax information is available in Publication 15-A, Employer's Supplemental Tax Guide. Publication 15-A includes specialized information supplementing the basic employment tax information provided in this publication.

Again, remember that in addition to federal tax, each state and municipality may have its own withholding tax laws which must be observed and accounted for.

4. Sales and Use Tax

California retailers are required to pay sales and use taxes and file tax returns. Although you are required to pay and report sales and use taxes to the Board of Equalization (BOE), you may be reimbursed by your customer for the amount of tax you owe on a sale. It is the retailer's responsibility to report the correct amount of tax for the sale and to pay the tax to the BOE to avoid paying a penalty and interest charges.

California retailers are required to obtain a seller's permit. When you obtain your seller's permit, you will be instructed to file your tax return on a monthly, quarterly, or annual basis. The BOE will send you a tax return form (BOE-401 or BOE-1150 series) to complete at the close of each reporting period.

In California, each municipality may have a different sales tax, so you must know how much in sales tax you must collect and report.

For California businesses, you should consult the California State Board of Equalization regarding sales taxes: http://www.boe.ca.gov/

Sales taxes collected are not income, and should not appear on the income statement, and the payment of sales tax is not an operating expense. However, since sales tax is collected, it is cash received by the business and should appear on the statement of cash flow. Likewise, when payment of the sales tax is made to the taxing body, it will appear as a debit on the statement of cash flow. Finally, sales tax collected but not yet paid would appear on the balance sheet as both a cash asset and an accrued liability. A sample balance sheet showing sales tax collected but not yet paid follows:
5. Real Property Tax

In California, all real property is taxable unless otherwise provided for in the California Constitution. Property is taxed in the county where it is owned, claimed, possessed, controlled or managed. The maximum general tax rate is one percent plus any bonds approved by popular vote. If you need further information, contact the applicable county assessor. For information about state-assessed property, visit the BOE Website, State-Assessed Properties Program.

6. Unsecured Personal Property Tax

In addition to real property, counties may tax a business’s personal property. Personal property includes business assets such as computers, furniture, etc.

7. Vehicle Tax

Businesses owning vehicles may be subject to a state vehicle tax.

8. Special Tax

The California BOE administers several taxes and fees in addition to the state's sales and use taxes. Some of the other tax and fee programs the BOE administers are excise taxes, fuel taxes, and environmental fees.
9. Business Tax

Many cities require the payment of a business tax for the privilege of operating a business within the city. If your business has offices in multiple cities, you will probably be required to pay a separate tax to each city in which you keep an office.

10. Where to include Taxes on your Financial Statements

As stated above, your sales tax collected but not yet paid would appear on your balance sheet, and all sales tax collected and all sales tax paid would show on your statement of cash flow. However, sales tax will not appear on your income statement. All other taxes, except for income taxes, can be listed as an operating expense on your income statement. Income taxes will also appear on your income statement, but not as an operating expense. All taxes will be included in your statement of cash flows.

<table>
<thead>
<tr>
<th>Income Statement Sample Company</th>
<th>01/01/13 – 12/31/13</th>
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<tbody>
<tr>
<td>Revenue</td>
<td>204,000</td>
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<tr>
<td>COGS</td>
<td>67,540</td>
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<td>Gross Profit</td>
<td>136,460</td>
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<td>Operating Expenses</td>
<td></td>
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<tr>
<td>Rent</td>
<td>6,480</td>
</tr>
<tr>
<td>Payroll + Payroll Taxes</td>
<td>66,000</td>
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<tr>
<td>Telephone</td>
<td>480</td>
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<tr>
<td>Insurance</td>
<td>780</td>
</tr>
<tr>
<td>Utilities</td>
<td>1,200</td>
</tr>
<tr>
<td>Advertising</td>
<td>2,400</td>
</tr>
<tr>
<td>Supplies</td>
<td>1,200</td>
</tr>
<tr>
<td>Acc/Legal</td>
<td>2,400</td>
</tr>
<tr>
<td>Outside Serv</td>
<td>4,800</td>
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<tr>
<td>Interest</td>
<td>539</td>
</tr>
<tr>
<td>Depreciation</td>
<td>7,000</td>
</tr>
<tr>
<td>Bus &amp; Urs Taxes</td>
<td>156</td>
</tr>
<tr>
<td>Total Expenses</td>
<td>(98,435)</td>
</tr>
<tr>
<td>Operating Income</td>
<td>43,025</td>
</tr>
<tr>
<td>Income Taxes</td>
<td>8605</td>
</tr>
<tr>
<td>Net Income After Taxes</td>
<td>34,420</td>
</tr>
</tbody>
</table>
Sales Forecast

Your sales forecast should be demonstrated monthly for the first year, and then annually for the ensuing three years. You should state your underlying assumptions in detail.

For any company, resources must be forecast in order to ensure that the products or services make it to the selling stage. Both types of forecasts can be undertaken based on an entrepreneur's sense of the market and its wants, market surveys of customer preferences and buying patterns, time-series analyses, which examine the past relationship between sales and time to determine patterns on which to base a forecast, and econometric models, which take into account the factors affecting sales and production including price, competing products, complementary products, availability of credit, consumer tastes and other key components.

Depending upon the type of business, there are a number of potential forecasting methods which should provide at least a ballpark estimate. For example, the National Restaurant Association and trade publication annual industry surveys provide a wealth of information about potential sales by type of restaurant food, price range, location, demographics, geographic marketing area, type of restaurant (e.g., fast food vs. family-style), and other statistics, along with average operational costs, gross margin, and earnings before taxes. Other trade associations, consultants, and the Internet are excellent sources.

Sales Forecasting Method #1

For your type of business, what is the average sales volume per square foot for similar stores in similar locations and similar size? This isn't the final answer for adequate sales forecasting, since a new business won't hit that target for perhaps a year. But this approach is far more scientific than a general 2 percent figure based on household incomes.

Sales Forecasting Method #2

For your specific location, how many households needing your goods live within say, one mile? How much will they spend on these items annually, and what percentage of their spending will you get, compared to competitors? Do the same for within five miles (with lower sales forecast figures). (Use distances that make sense for your location.)

Sales Forecasting Method #3

If you offer say, three types of goods plus two types of extra cost services, estimate sales revenues for each of the five product/service lines. Make an estimate of where you think you'll be in six months (such as "we should be selling five of these items a day, plus three of these, plus two of these.") and calculate the gross sales per day. Then multiply by 30 for the month.

Now scale proportionately from month one to month six; that is, build up from no sales (or few sales) to your six month sales level. Now carry it out from months six through 12 for a complete annual sales forecast.
Research on the economy can assist you in developing your sales forecast. Principal Global Indicators can give you valuable economic data. For example, an query on US market indicators can yield the following:
The University of Central Florida Libraries provides links to various economic data:
The Economic Cycle Research Institute provides some free information on business cycle data, including future inflation gauge.
Economic Indicators and Releases

This page is updated Monday through Friday and was last updated June 3, 2011. If the release page doesn’t look current, click the reload or refresh button on your browser. To request additional releases to be added to this webpage, e-mail jean Roth at jean@nber.org.

Calendar of releases by date, by title, and as a comma separated variable file.

Register to receive free e-mail notification of new economic releases that you specify.

New Economic Releases RSS feed

Search the list of the new releases

Display results sorted by Date Date Title

<table>
<thead>
<tr>
<th>Current Release</th>
<th>Latest Update</th>
<th>Usual Time</th>
<th>Home / Archive</th>
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<td>Jun. 3, 2011</td>
<td>10:30 a.m.</td>
<td>Home Archive</td>
<td>Fridays</td>
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<tr>
<td>Employment Situation (Includes Nonfarm Payrolls, Unemployment Rate, Average Workweek, and Hourly Earnings)</td>
<td>Jun. 3, 2011</td>
<td>8:30 a.m.</td>
<td>Home Archive</td>
<td>Schedule</td>
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<tr>
<td>Euro Area Monetary Financial Institution (MFI) Interest Rate Statistics</td>
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<td>4 p.m.</td>
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<td>ISM Service Index</td>
<td>Jun. 3, 2011</td>
<td>10 a.m.</td>
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<tr>
<td>Federal Reserve Board (updated daily)</td>
<td>Jun. 3, 2011</td>
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<td>Home Archive</td>
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<td>Factors Affecting Reserve Balances (H11)</td>
<td>Jun. 3, 2011</td>
<td>4:30 p.m.</td>
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<td>Jun. 3, 2011</td>
<td>8:30 a.m.</td>
<td>Home Archive</td>
<td>Schedule</td>
</tr>
</tbody>
</table>

Resources:

http://www.principalglobalindicators.org

http://libguides.lib.ucf.edu/

http://www.businesscycles.com

http://www.nber.org/releases/
Employees

The Bureau of Labor Statistics has Occupational Compensation Surveys (OCS) for most geographical areas in the United States. The information is broken down by the type of occupation as well as by various levels within that occupation. The advantage of using these surveys is that they reflect data in your geographical area so you can get an idea of what employers in your area are paying for a specific job. The government also has information about benefits and other statistical information related to employment.

The Internet also has more specific information regarding the salaries in certain professions, industries, and locales. You could get comparative wage surveys from a variety of sources including company and trade associations, professional associations, and chambers of commerce.

Remember that if your firm hires employees it must follow pertinent federal wage and hour laws as well as state regulations, which will vary by state. Furthermore, do not make the mistake of merely classifying all workers as independent contractors so as to avoid the expense and regulations associated with employees. Independent contractors are not employees and therefore will not be eligible for employee benefits, nor will you generally be required to collect and pay payroll tax or maintain worker’s compensation insurance. However, if you have employees who are erroneously classified as independent contractors, you may face substantial civil as well as criminal penalties.
Competitive Analysis

Your competitors are not always who you think they are. For example, if you are a manufacturer of crackers, your direct competitors are probably other brands of crackers in the market. But what about other makers of snack food, such as popcorn, tortilla chips, peanuts, snack mixes, or potato chips? And what about rice cakes, candy bars, cake/pie items, rolled candy, gum, or frozen confections? The target consumer may be making a choice among all these items for a "snack" purchase, including crackers! Or the target buyer may be considering a snack purchase among alternatives for a "snack."

A company must narrow its choices and decide which industry, product or service categories, brands, geographic areas, channels of distribution, etc., to compete in. Without this knowledge and analysis, your marketing programs will not be effective and efficient, particularly if you have a very limited budget.

You might wish to categorize your competitors in different levels, starting with your most direct competitors and moving on to indirect competitors.

Level One Competitors: the specific brands which are direct competitors to your product or service, in your geographic locality. In many cases, these competitors offer a product or service which is interchangeable with yours in the eyes of the consumer.

Level Two Competitors: competitors who offer similar products in a different business category or who are more geographically remote. These competitors may not offer the exact same mix of products and services as your firm, but they may be offering some of the same product and services as your company.

Level Three Competitors: competitors who provide goods or services which are an alternative to what you are providing. For example, if you produce crackers, your target customer may choose to spend his money not on your cracker, but the snack alternative of soda pop.

The key is to remember that from the buyer’s perspective, the buyer could choose to spend money on your product, on the same kind of product offered by another manufacturer, or on something else entirely. Knowing what options your customer has allows you to develop your strategy to effectively compete against all competitors, not just those directly competing with you.

Basic information every company should know about their competitors includes:

1. each competitor's market share, as compared to your own
2. how target buyers perceive or judge your competitors' products and services
3. your competitors' financial strength, which affects their ability to spend money on advertising and promotions, among other things
4. each competitor's ability and speed of innovation for new products and services
Every competitor has definitive weaknesses and strengths that may be points of potential advantage for your company and products. In most cases, larger companies cannot make decisions or allocate resources, personnel, and materials as fast as a smaller company under changing market conditions. Smaller companies may have to be content with a limited, but profitable, objective of taking what they can from the market before larger competitors catch up later.

It is also important for smaller companies to decide when the cost of direct competition is both unwise and ineffective. For example, a small, local soft drink company cannot afford to match every new flavor and size of soft drink that larger national companies introduce and support with marketing programs. It must develop its own unique flavors and stick to selling and distributing only the sizes that sell rapidly in its own markets, with limited marketing spending support.

In your competitive analysis, you should address the following issues:

1. Who are your closest competitors, and what are their products or services?
2. Where are they located?
3. What are their revenues?
4. How long have they been in business?
5. What percentage of market share do they currently hold?
6. If they are struggling, why?
7. If they are successful, why?
8. Do they serve a local market, a national market, an international market, or a global market? How does this compare to what kind of market your serve?
9. In what other ways are your operations the same, or how else do they differ?
10. Are your competitors declining, remaining stable, or growing?
11. Do your competitors surpass your operations in any manner, and if so, how will you address this deficiency?

Your competitive analysis should identify attributes which your customers find important, ranked in order of their importance. A good way to do this would be to conduct a survey. If you are using a survey, though, you should start early to give yourself the best chance of getting sufficient responses. In addition, you should include a copy of your survey in an appendix to your business plan. In addition, you should explain your methodology.

You can summarize your competitive analysis in a variety of ways, including using a table. If you use a table to summarize your results, the table should include a key which identifies how the results were determined, and if results are expressed numerically, please explain what the scale is.
Based on a Scale of 1-5 with 5 being most favorable; Data derived from online customer survey conducted 01/10/10 with 300 respondents

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<tr>
<th>Factor</th>
<th>My Business</th>
<th>Company A</th>
<th>Company B</th>
<th>Company C</th>
<th>Importance to Customer</th>
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<td>3</td>
<td>5</td>
<td>2</td>
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<tr>
<td>Price</td>
<td>4</td>
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<td>5</td>
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<tr>
<td>Quality</td>
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<td>4</td>
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<td>Selection</td>
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<td>Service</td>
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<td>Reliability</td>
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<td>Market Growth</td>
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<td>Weighted Average</td>
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An example of competitive analysis using SWOT:

<table>
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<tr>
<th>Strengths</th>
<th>My Company</th>
<th>Competitor 1</th>
<th>Competitor 2</th>
<th>Competitor 3</th>
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<tr>
<td>What are your business advantages?</td>
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<tr>
<td>What are your core competencies?</td>
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<tr>
<td>Where are you making the most money?</td>
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<tr>
<td>What are you doing well?</td>
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<tr>
<td>Weaknesses</td>
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<td>What areas are you avoiding?</td>
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<tr>
<td>Where do you lack resources?</td>
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<tr>
<td>What are you doing poorly?</td>
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<td></td>
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<tr>
<td>Where are you losing money?</td>
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<tr>
<td>What needs improvement?</td>
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<td>Opportunities</td>
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<tr>
<td>Any beneficial trends?</td>
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<td>Niches that competitors are missing?</td>
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<td>New needs of customers?</td>
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<td>Threats</td>
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<td>Obstacles to overcome?</td>
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<td>Successful competitors?</td>
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<td>Negative economic conditions?</td>
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<td></td>
</tr>
<tr>
<td>Government regulation?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Changing business climate?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vulnerabilities?</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Research:

Review trade association journals for information regarding the industry and your competitors.

Information regarding publicly traded companies can be found at the Securities Exchange Commission: http://www.sec.gov/edgarhp.htm

Dun & Bradstreet’s Zapdata at http://www.zapdata.com

Hoover’s Online at http://www.hoovers.com

Thomas Register at http://www.thomasnet.com

Thomas Regional at http://thomasregional.com

Thomas Global Register at http://www.tgrnet.com
Target Market

Do you know who your buyers are? Do you understand why they buy your products or services? Assuming that other factors in making the product available (distribution) and known to the buyer (advertising and promotion) are in effect, influences on the buyer may be catalogued by culture, demographics, lifestyle or psychology of wants and needs.

If your target buyer is also the end user of your products and services, then demographic, lifestyle, and other target buyer identification and classification are appropriate. However, if intermediate buyers are involved prior to products reaching the end user, other influences may be important.

If your product is funneled through a master distributor, who sells to local or regional distributors, influences which may affect buying patterns include the profitability of the item, availability of discounts, existence of advertising and promotion support programs, payment of slotting fees, availability of samples, personal relationships, and sales incentive programs.

It is therefore necessary to define your target market in terms as specific as possible. Market segmentation subdivides a market along some commonality. The purpose of segmentation is to enable a seller to concentrate its marketing dollars and develop a successful strategic plan.

Geographic Segmentation

This is perhaps the most common form of market segmentation, wherein companies segment the market by attacking a restricted geographic area. For example, corporations may choose to market their brands in certain countries, but not in others. A brand could be sold only in one market, one state, or one region of the United States. Many restaurant chains focus on a limited geographic area to achieve concentration of force. Regional differences in consumer preferences exist, and this often provides a basis for geographic specialization.

Distribution Segmentation

Different markets can be reached through different channels of distribution. For example, a company might segment the “tick and flea collar” market by selling the product to supermarkets under one brand name, to mass merchandisers under another brand, to pet stores under another brand name, and to veterinarians under yet another brand name. This type of distributional segmentation is common, especially among small companies that grant each channel a unique brand to gain distribution within that channel. Other examples of distributional segmentation would be an upscale line of clothing sold only in expensive department stores, or a hair shampoo sold only through upscale beauty salons.

Media Segmentation

While not common, media segmentation is sometimes a possibility. It is based on the fact that different media tend to reach different audiences. If a brand pours all of its budget into one media, it can possibly dominate the segment of the market that listens to that radio station or reads that magazine. Media segmentation is most often practiced by companies that have some control over the media and can somehow discourage competitors from using that media.
Price Segmentation

Price segmentation is common and widely practiced. Variation in household incomes creates an opportunity for segmenting some markets along a price dimension. If personal incomes range from low to high, the reasoning goes, then a company should offer some cheap products, some medium-priced ones, and some expensive ones.

Demographic Segmentation

Gender, age, income, housing type, and education level are common demographic variables. Some brands are targeted only to women, others only to men. Education levels often define market segments.

Time Segmentation

Time segmentation is less common but can be highly effective. Some stores stay open later than others, or stay open on weekends. Some products are sold only at certain times of the year.

Psychographic or Lifestyle Segmentation

Lastly, is psychographic segmentation, based upon analyses of consumer attitudes, values, behaviors, emotions, perceptions, beliefs, and interests.
Marketing Plan

Your business plan must contain a marketing plan. The marketing plan should be imaginative, specifically targeted to your target market, realistic in its approach, and include a budget.

One of the most common mistakes business owners make is that they will include an unimaginative marketing plan which is unrealistic in its goals, and contains no credible data regarding its cost. Further, entrepreneurs will often identify their website as their primary marketing tool, and even list it as a competitive advantage, but then admit that they haven’t even developed the website. If you are going to claim that your website will draw in many of your customers, you must show the website. Claiming as a competitive advantage a website that has yet to be created is an easy way to lose credibility in your business plan.

In preparing your marketing plan, you may want to consider the following:

Step 1. Determine who the target buyer is. Identification of exactly who the target buyer is, in demographic, lifestyle, and other descriptive terms, is necessary before the construction of practical promotion, advertising, and public relations (PR) programs.

Step 2. Determine what is meaningfully unique about your product. Many small businesses can describe what is meaningfully unique about their product or service. For other businesses, careful market research may be the only way to determine meaningful sources of uniqueness on product features and benefits. For our purposes, "meaningful" differences are defined as those business or brand attributes that buyers or end users consider in making purchase decisions among different available choices. Customer perceptions control what is "meaningful."

Step 3. Construct a business positioning strategy statement. It is important to be consistent in all promotion, advertising, and PR programs, particularly with the scarce resources of most small businesses. A good business positioning strategy statement will address who the target buyer or end user is, what the competitive environment is, and what the meaningful differences in the products or services are when compared to the competition. The statement might also include reasons why these meaningful differences are valuable and perhaps some idea of a business "personality" that will be created and fostered in all marketing programs.
Step 4. Determine the best message to communicate your product positioning to target buyers. The key to communicating product uniqueness and positioning is constructing a memorable unique selling proposition (USP) about product features and benefits that are meaningful to your target buyer. This USP may be a memorable "slogan" or ad message that correlates with the needs and wants of your target buyer. The ad message is a result of a carefully constructed positioning statement.

Step 5. Determine promotion and advertising options and costs in terms of available budget. There is never enough money to do everything desirable to build the business. Often a promotional budget reality check for a small business means a choice between a little promotion, advertising, or PR, but not all three at the same time.

You can begin by researching the marketing strategy of your competitors. If their strategy is working, you may want to copy it. If not, then you know what not to do in developing your own strategy.

Once you develop a strategy, you must then develop a system to measure its effectiveness.

Once a small business has determined both its business positioning strategy and the size of the promotional budget, specific promotional activities can be selected. Promotion programs provide direct purchase incentives in contrast to most advertising, which provides reasons to buy your product instead of the competing brand.

Typical promotional activities:
- games and contests
- premiums and gifts
- coupons and rebates
- product or service demonstrations

Advertising is impersonal, usually paid communication intended to inform, educate, persuade, and remind.

Advertising is a sophisticated form of communication that must work with other marketing tools and business elements to be successful. Advertising must be interruptive — that is, it must make you stop thumbing through the newspaper or thinking about your day long enough to read or hear the ad. Advertising must also be credible, unique, and memorable in order to work.

And finally, assuming the actual advertising is built upon a solid positioning strategy, enough money must be spent to provide a media schedule for ad frequency, the most important element for ad memorability.
Word-of-mouth advertising. Word-of-mouth advertising has existed as long as mankind has communicated and traded goods and services. Word-of-mouth advertising is considered the most effective form. Word-of-mouth has the desired qualities of strong credibility, high audience attention levels, and friendly audience reception. It features open-ended conversation with questions and answers about the product, psychological incentives to purchase, memorability, efficiency and frequency. Word-of-mouth advertising passes product information to many other potential buyers (and may even include promotional trial demonstrations and free sampling), at little or no cost to the business. Whenever possible, a small business should build an advertising program that results in word-of-mouth advertising! Satisfied customers are your best advertisements.

In some respects, typical media advertising (e.g., the Miller Light "less filling/more taste" ads) acts only as a catalyst to achieve word-of-mouth advertising and increased sales. Successful advertising will achieve many times more ad mentions through word-of-mouth than the number of paid media presentations of the ads.

To build an effective advertising campaign, consider the following:

Make sure your ads are "on strategy" with your business positioning. A good positioning strategy ensures identification of the correct target audience for your advertising, along with a listing of meaningful features and benefits. It can provide reasons why the product is superior and unique, along with an advertising "personality."

How much should you spend on advertising your business? The price to promote your company can escalate quickly -- newspaper ads, banners, radio spots, direct mail, online marketing, telemarketing. It all adds up. Here are four methods for setting an advertising budget:

1. Fixed percentage of sales. Start with last year’s total gross sales or average sales for the past few years, then allocate a specific percentage of that figure for advertising.

2. Comparable to the competition. Adopt the industry average for ad budgets for your company. Many trade associations and industry publications can provide the average amount or percentage companies spend on advertising.

3. Objective and task-based. Begin by setting specific marketing objectives and deciding on the tasks required to meet those objectives. (Example: Increase out-of-state clients by 5% using online promotions.) Then determine your budget by estimating the costs of carrying out those tasks. If you can’t afford to fund all your ideas, rank them and focus on the top few.

4. The maximum amount. Lots of fast-growing businesses put their faith in this strategy, which advocates setting aside just enough money to sustain the business -- and your family -- then spending the rest on advertising.
SWOT Analysis

SWOT is an acronym used to describe the particular Strengths, Weaknesses, Opportunities, and Threats that are strategic factors for a specific company. A SWOT analysis should identify the firm’s core competencies.

A comprehensive SWOT analysis should include an honest assessment of your market. It will include internal factors, such as strengths and weaknesses, and external factors, such as opportunities and threats.

To assess your market, ask yourself the following:

1. What is happening externally and internally that will affect our company?
2. Who are our customers?
3. What are the strengths and weaknesses of each competitor?
4. What are the driving forces behind sales trends?
5. What are important and potentially important markets?
6. What is happening in the world that might affect our company?
7. What does it take to be successful in this market? (List the strengths all companies need to compete successfully in this market.)

Next you should assess your company:

1. What do we do best?
2. What are our company resources – assets, intellectual property, and people?
3. What are our company capabilities (functions)?

Finally, assess your competition:

1. How are we different from the competition?
2. What are the general market conditions of our business?
3. What needs are there for our products and services?
4. What are the customer-market-technology opportunities?
5. What are the customer’s problems and complaints with the current products and services in the industry?
6. What do customers find lacking?

The internal analysis of strengths and weaknesses deals with internal factors which result in advantages and disadvantages for a firm in meeting the needs of its target market. Strengths would consist of core competencies that give a company an advantage. Strengths are only meaningful if they assist a company in meeting the needs of its customers.

Weaknesses refer to any limitations a company faces in developing or implementing a strategy. Weaknesses should also be examined from a customer perspective because customers often perceive weaknesses that a company cannot see.
When assessing internal performance, one must consider the company’s resources. Is the company profitable? Does the company have product quality and does it enjoy brand identity? Does it have quality personnel?

The External Analysis examines opportunities and threats that exist in the environment. Both opportunities and threats exist independently of the firm. The way to differentiate between a strength or weakness from an opportunity or threat is to ask: Would this issue exist if the company did not exist? If the answer is yes, it should be considered external to the firm. Opportunities refer to favorable conditions in the environment that could produce rewards for the organization if acted upon properly. That is, opportunities are situations that exist but must be acted on if the firm is to benefit from them. Threats refer to conditions or barriers that may prevent the firms from reaching its objectives.

The goal of the SWOT analysis is to turn weaknesses into strengths, match internal strengths to external opportunities, and convert external threats into opportunities. The SWOT analysis will be used in conducting a firm’s strategic planning.

<table>
<thead>
<tr>
<th>Functional Area</th>
<th>Capability</th>
<th>Example</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate</td>
<td>Financial management</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Expertise in strategic control</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Effectiveness in motivating and coordinating business units</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Management of partnerships</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Overall company</td>
<td></td>
</tr>
<tr>
<td></td>
<td>management/resource management</td>
<td></td>
</tr>
<tr>
<td>Information Management</td>
<td>Comprehensive and effective information system that can be used for managerial decision making</td>
<td></td>
</tr>
<tr>
<td>Research and Development</td>
<td>Capability in basic research</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Innovation of new products</td>
<td></td>
</tr>
<tr>
<td>Manufacturing</td>
<td>Product Design</td>
<td>Design capability</td>
</tr>
<tr>
<td>Marketing</td>
<td>Brand management and promotion</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Promotion and exploiting reputation for quality</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Understand of and responsiveness to market trends</td>
<td></td>
</tr>
<tr>
<td>Sales and Fulfillment</td>
<td>Effectiveness in promoting and executing sales</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Efficiency and speed of fulfillment</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Quality and effectiveness of customer service</td>
<td></td>
</tr>
</tbody>
</table>
For your business plan, you must explain your SWOT in detail. Bullet points are not sufficient to convey your SWOT analysis. Once explained, however, it may also be summarized by use of visual aids.

<table>
<thead>
<tr>
<th>Positive</th>
<th>Negative</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Strengths</strong></td>
<td><strong>Weaknesses</strong></td>
</tr>
<tr>
<td>Technological skills</td>
<td>Absence of important skills</td>
</tr>
<tr>
<td>Leading Brands</td>
<td>Weak brands</td>
</tr>
<tr>
<td>Distribution channels</td>
<td>Poor access to distribution</td>
</tr>
<tr>
<td>Customer Loyalty / Relationship</td>
<td>Low customer retention</td>
</tr>
<tr>
<td>Production quality</td>
<td>Unreliable product / service</td>
</tr>
<tr>
<td>Scale</td>
<td>Sub-scale</td>
</tr>
<tr>
<td>Management</td>
<td>Management</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Internal Factors</th>
<th>External Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Opportunities</strong></td>
<td><strong>Threats</strong></td>
</tr>
<tr>
<td>Changing customer tastes</td>
<td>Changing customer tastes</td>
</tr>
<tr>
<td>Liberalisation of geographic markets</td>
<td>Closing of geographic markets</td>
</tr>
<tr>
<td>Technological advances</td>
<td>Technological advances</td>
</tr>
<tr>
<td>Changes in government politics</td>
<td>Changes in government politics</td>
</tr>
<tr>
<td>Lower personal taxes</td>
<td>Tax increases</td>
</tr>
<tr>
<td>Change in population age-structure</td>
<td>Change in population age-structure</td>
</tr>
<tr>
<td>New distribution channels</td>
<td>New distribution channels</td>
</tr>
</tbody>
</table>
1. Property insurance — this insurance will cover losses arising from physical damage or loss of use of the property or theft losses. Remember to insure against the losses of the contents of your business, too. It is very possible to have a larger investment in machinery and equipment, inventory, and business records than the actual business building.

2. Business interruption insurance — this type of insurance will pay your bills while you are out of operation for a covered loss, such as a fire. Just because your business is shut down does not mean that your bills will stop. This type of insurance can also provide your business with the lost profit protection, although such coverage is expensive.

3. Liability insurance — this type of insurance protects you if you are sued. It will pay judgments against you up to the policy limits, as well as the legal fees you incur in defending yourself. Some small businesses, such as doctors and lawyers, will also need to carry professional liability coverage, which protects the insured against lawsuits that result from professional error.

4. Key man insurance — this type of insurance includes coverage for the owner's or manager's death or disability. It is meant to get a company through the tough times following the loss of a key person and includes a buyout of the deceased owner's interest at the time of death.

5. Workers' compensation insurance — this type of coverage is necessary for those small businesses that have employees. It varies by state and employee job duty classification. The cost will vary based upon the worker classification.

6. Health insurance — this type of insurance pays the medical bills for covered illnesses and injuries. Buying insurance through your business can be cheaper than buying an individual policy for yourself. Because of the high costs, most small employers don't offer health insurance as an employee benefit.

7. Life and disability insurance — these policies provide covered individuals or their families with income in the event of death (life insurance) or a disability not related to work (disability insurance). These types of insurance are relatively inexpensive.

8. Auto Insurance – Even if it is totally unrelated to your business, an auto accident that leads to a
large legal judgment against you can be hazardous to your personal economic health and to that of your home business. Because of this, it's important that you have an adequate amount of coverage on your car to cover both business- and nonbusiness-related accidents and damage to your auto. Auto insurance has two main components: liability insurance and insurance for property damage. Liability insurance is the most important. It provides compensation to persons who would be able to sue you for personal injuries, medical payments, loss of earnings, or damage to their property arising out of an auto accident. Property damage coverage includes such collision and comprehensive coverage, which compensate you for damage to your car, and assorted damage to it caused by such things as fire, theft, and vandalism.
Industry Analysis

Industry analysis is a study of the characteristics that influence the primary and secondary businesses that supply a related product. The industry analysis should provide the following four types of information:

1. The characteristics that define the industry
   a. The products or services provided
   b. Scope and geography of markets
   c. Major competitors
   d. Demographics of major customers

2. Description of the economic, competitive, social, legal and political factors that drive the industry and that directly impact the firm’s performance

3. Historical trends of sales and profits in the industry
   a. Explanation of factors responsible for this performance
   b. Outlook for future sales and profits, and the reasons for those projections

4. Description of the strategic opportunities that exist for firms in this industry, why those opportunities exist, and how the business plans to exploit those opportunities

Your industry analysis should be comprehensive and specific. Do not make conclusionary statements in your business plan. Each assertion you proffer should be supported by data, facts and research.

There are several factors you must consider as you analyze your industry:
1. Will you use a local, regional, state, national, or international geographic area?
2. What is the size of the industry?
   This may be expressed in dollars and/or products/services sold
3. What trends are there?
   This may include operational/management trends within the industry
   This may also include trends in sales over recent years
4. What is the industry outlook?
5. What is the regulatory environment?
6. What types of marketing strategies are prevalent within the industry?
7. Is the industry seasonal and/or sensitive to economic fluctuations?
8. Identify and research the most successful businesses.
**Identify the Industry:** Identify your industry by determining the Standard Industrial Classification (SIC) code and/or the NAICS Code for the industry. You can find this information at the US Census Website: [http://www.census.gov/eos/www.naics/](http://www.census.gov/eos/www.naics/)

**Industry Overview:** Your overview should include a brief history, factors that affect growth, government regulations and leading business in the industry.

**Research:** To assist in this research, helpful sources may include

  Hoover’s Online at [http://www.hoovers.com](http://www.hoovers.com) for information on leading companies and industries.

Dun & Bradstreet offers free statistical industry data at [http://www.zapdata.com](http://www.zapdata.com).

Free trade journal downloads can be found at [http://allbusiness.tradepub.com/](http://allbusiness.tradepub.com/)

SBDCnet at [http://www.sbdnet.org](http://www.sbdnet.org)


The University of Central Florida offers links to multiple government resources at [http://guides.ucf.edu/content.php?pid=46314&sid=342371#1023099](http://guides.ucf.edu/content.php?pid=46314&sid=342371#1023099)

[http://www.bizstats.com](http://www.bizstats.com) Can give you information on your particular industry. For example, average ratios for a corporate food and beverage retailer is as follows:

2006 Food and Beverage Retailer

<table>
<thead>
<tr>
<th>Corp Average Financial Ratios</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Return on Sales (%)</td>
<td>3.34</td>
</tr>
<tr>
<td>Return on Assets (%)</td>
<td>9.38</td>
</tr>
<tr>
<td>Return on Net Worth (%)</td>
<td>25.12</td>
</tr>
<tr>
<td>Quick Ratio</td>
<td>0.40</td>
</tr>
<tr>
<td>Current Ratio</td>
<td>0.99</td>
</tr>
<tr>
<td>Inventory Turnover (x)</td>
<td>18.33</td>
</tr>
<tr>
<td>Assets:Sales (%)</td>
<td>0.36</td>
</tr>
<tr>
<td>Total Liabilities:Net Worth (x)</td>
<td>2.68</td>
</tr>
</tbody>
</table>
Its profit & loss statement is as follows:

<table>
<thead>
<tr>
<th>Food and beverage stores</th>
<th>Corp Annual Average Sales, Income &amp; Expense 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>100%</td>
</tr>
<tr>
<td>Cost of Sales</td>
<td>71.96%</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>28.04%</td>
</tr>
<tr>
<td>Officers Comp</td>
<td>0.44%</td>
</tr>
<tr>
<td>Salary-Wages</td>
<td>9.44%</td>
</tr>
<tr>
<td>Rent</td>
<td>1.82%</td>
</tr>
<tr>
<td>Taxes</td>
<td>1.53%</td>
</tr>
<tr>
<td>Interest paid</td>
<td>0.59%</td>
</tr>
<tr>
<td>Amort. &amp; Dep.</td>
<td>1.52%</td>
</tr>
<tr>
<td>Advertising</td>
<td>0.70%</td>
</tr>
<tr>
<td>Benefits-Pension</td>
<td>1.63%</td>
</tr>
<tr>
<td>Other SG&amp;A Exp.</td>
<td>7.03%</td>
</tr>
<tr>
<td>Net Profit</td>
<td>3.34%</td>
</tr>
</tbody>
</table>

The balance sheet is as follows:

<table>
<thead>
<tr>
<th>Food and beverage stores</th>
<th>Corp Average Balance Sheet 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>6.02</td>
</tr>
<tr>
<td>Receivables</td>
<td>7.38</td>
</tr>
<tr>
<td>Inventory</td>
<td>15.34</td>
</tr>
<tr>
<td>Other Current Assets</td>
<td>4.34</td>
</tr>
<tr>
<td>Total Current Assets</td>
<td>33.08</td>
</tr>
<tr>
<td>Fixed Assets</td>
<td>49.27</td>
</tr>
</tbody>
</table>
### Table of Financial Statements

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other Non-Current Assets</td>
<td>18.63</td>
</tr>
<tr>
<td>Total Assets</td>
<td>100</td>
</tr>
<tr>
<td>Accounts Payable</td>
<td>22.17</td>
</tr>
<tr>
<td>Other Current Liabilities</td>
<td>8.94</td>
</tr>
<tr>
<td>Total Current Liabilities</td>
<td>31.11</td>
</tr>
<tr>
<td>Other Long-Term Liabilities</td>
<td>8.94</td>
</tr>
<tr>
<td>Total Liabilities</td>
<td>62.66</td>
</tr>
<tr>
<td>Net Worth</td>
<td>37.34</td>
</tr>
<tr>
<td>Total Liabilities &amp; Net Worth</td>
<td>100</td>
</tr>
</tbody>
</table>

When comparing your business to others within the industry, is its value within the norms? For example, valuation rules of thumb by industry could be:

<table>
<thead>
<tr>
<th>Industry</th>
<th>&quot;Rule of Thumb&quot; Valuation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting Firms</td>
<td>100 – 125% of annual revenues</td>
</tr>
<tr>
<td>Auto Dealers (New Cars)</td>
<td>10 to 12% of annual sales + inventory</td>
</tr>
<tr>
<td>Book Stores</td>
<td>15% of annual sales + inventory</td>
</tr>
<tr>
<td>Coffee Shops (Gourmet)</td>
<td>45% of annual sales + inventory</td>
</tr>
<tr>
<td>Day Care Centers</td>
<td>40 – 45% of annual sales incl. inventory</td>
</tr>
<tr>
<td>Dental Practices</td>
<td>60 – 65% of annual revenues incl. inventory</td>
</tr>
<tr>
<td>Dry Cleaners</td>
<td>70% of annual sales + Inventory</td>
</tr>
<tr>
<td>Engineering Services</td>
<td>40 – 45% of annual revenues</td>
</tr>
<tr>
<td>Flower Shops</td>
<td>30% of annual sales + inventory</td>
</tr>
<tr>
<td>Food Shops (Gourmet)</td>
<td>20% of annual sales + inventory</td>
</tr>
<tr>
<td>Gas Stations (w/o C-Store)</td>
<td>15 – 20% of annual sales + inventory</td>
</tr>
<tr>
<td>Gift/Card Shops</td>
<td>35% of annual sales incl. inventory</td>
</tr>
<tr>
<td>Grocery Store (Supermarket)</td>
<td>8 – 10% of annual sales + inventory</td>
</tr>
<tr>
<td>Hardware Stores</td>
<td>50% of annual sales incl. inventory</td>
</tr>
<tr>
<td>Business Category</td>
<td>Estimated % or % Range of Annual Sales + Inventory</td>
</tr>
<tr>
<td>----------------------------</td>
<td>---------------------------------------------------</td>
</tr>
<tr>
<td>Insurance Agencies</td>
<td>175 – 200% of annual revenues</td>
</tr>
<tr>
<td>Landscape Businesses</td>
<td>50% of annual sales</td>
</tr>
<tr>
<td>Law Practices</td>
<td>40 – 100% of annual revenues</td>
</tr>
<tr>
<td>Liquor Stores</td>
<td>35 – 40% of annual sales + inventory</td>
</tr>
<tr>
<td>Restaurants (Full-Serve)</td>
<td>30 – 35% of annual sales + inventory</td>
</tr>
<tr>
<td>Restaurants (Ltd-Serve)</td>
<td>40 – 45% of annual sales + inventory</td>
</tr>
<tr>
<td>Sporting Goods Stores</td>
<td>30% of annual sales + inventory</td>
</tr>
<tr>
<td>Taverns/Bars</td>
<td>40 -- 45% of annual sales + inventory</td>
</tr>
<tr>
<td>Travel Agencies</td>
<td>40 to 45% of annual commissions</td>
</tr>
<tr>
<td>Veterinary Practices</td>
<td>70% of annual revenues + inventory</td>
</tr>
</tbody>
</table>
Preparing the Financial Statements

1. Depreciation

There are various methods of depreciating assets. For purposes of this project, you may use straight-line depreciation, which is the simplest.

Depreciation is used because when an asset is purchased, it is not worth the same a year from now as it is when you bought it new. This needs to be reflected in the financial statements.

To calculate straight-line depreciation, you need to know the initial value of the item, its useful life, and its salvage value, if any.

For Example: You purchase equipment for $1,000. It has a useful life of 5 years and salvage value of $0. Your annual depreciation will be the initial value, less its salvage value, divided by its useful life. In our example: ($1,000 - $0) ÷ 5 = $200.


For example, under the ADS guidelines, recovery periods for certain assets are as follows:

<table>
<thead>
<tr>
<th>Property</th>
<th>Recovery Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rent-to-own property</td>
<td>4 years</td>
</tr>
<tr>
<td>Automobiles and light duty trucks</td>
<td>5 years</td>
</tr>
<tr>
<td>Computers and peripheral equipment</td>
<td>5 years</td>
</tr>
<tr>
<td>High technology telephone station equipment installed on customer premises</td>
<td>5 years</td>
</tr>
<tr>
<td>High technology medical equipment</td>
<td>5 years</td>
</tr>
<tr>
<td>Personal property with no class life</td>
<td>12 years</td>
</tr>
<tr>
<td>Natural gas gathering lines</td>
<td>14 years</td>
</tr>
<tr>
<td>Single purpose agricultural and horticultural structures</td>
<td>15 years</td>
</tr>
<tr>
<td>Any tree or vine bearing fruit or nuts</td>
<td>20 years</td>
</tr>
<tr>
<td>Initial clearing and grading land improvements for gas utility property</td>
<td>20 years</td>
</tr>
</tbody>
</table>
Initial clearing and grading land improvements for electric utility transmission and distribution plants 25 years

Electric transmission property used in the transmission at 69 or more kilovolts of electricity 30 years

Natural gas distribution lines 35 years

Any qualified leasehold improvement property 39 years

Any qualified restaurant property 39 years

Nonresidential real property 40 years

Residential rental property 40 years

Section 1245 real property not listed in Appendix B 40 years

Railroad grading and tunnel bore 50 years

In our previous example, we determined that the annual depreciation of the equipment is $200. This is known as its current depreciation, which will appear as an expense on the income statement. Each year, the equipment is depreciated by $200. At the end of four years, its accumulated depreciation is $800, which is calculated by multiplying the current depreciation by the number of years. Accumulated depreciation will show on the balance sheet, and will reduce the value of assets.

2. Cost of Goods Sold

COGS will be subtracted from our Gross Revenue on our income statement to determine our gross profit, so we must now calculate our COGS. To calculate COGS we find our beginning inventory, add our purchases and subtract our ending inventory. Ending inventory is calculated as follows: beginning inventory + purchased inventory - sold inventory.

EXAMPLE: We capitalize our business with 800 units of inventory worth $2/unit. During the year we buy an additional 500 units/month, and we sell 560 units/month. We will calculate our COGS for the year as follows:

First we will determine our ending inventory:

\[
\begin{align*}
\text{Beginning inventory} & \quad 800 \times 2 \quad = \quad 1600 \\
+ \quad \text{Purchased inventory} & \quad 500 \times 12 \times 2 \quad = \quad 12,000 \\
- \quad \text{Sold inventory} & \quad 560 \times 12 \times 2 \quad = \quad 13,440 \\
\text{Ending inventory} & \quad \quad \quad = \quad 160 \\
\end{align*}
\]

Now we can calculate our Cost of Goods Sold as follows:

\[
\begin{align*}
\text{Beginning inventory} & \quad 800 \times 2 \quad = \quad 1600 \\
+ \quad \text{Purchased inventory} & \quad 500 \times 12 \times 2 \quad = \quad 12,000 \\
- \quad \text{Ending inventory} & \quad \quad \quad = \quad 160 \\
\text{Cost of Goods Sold} & \quad \quad \quad = \quad 13,440 \\
\end{align*}
\]
3. Income Statement

The income statement is also known as the profit and loss statement. It will identify the name of the company and the time period for which the income statement reports. The income statement will begin with the revenue, then subtract out the Cost of Goods Sold to determine our gross profit.

From gross profit we will subtract our operating expenses, which will then reveal our operating income.

<table>
<thead>
<tr>
<th>Income Statement</th>
<th>Sample Company</th>
<th>01/01/10 – 12/31/10</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td></td>
<td>53,760</td>
</tr>
<tr>
<td>COGS</td>
<td></td>
<td>13,440</td>
</tr>
<tr>
<td>Gross Profit</td>
<td></td>
<td>40,320</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rent</td>
<td></td>
<td>6,000</td>
</tr>
<tr>
<td>Payroll</td>
<td></td>
<td>9,600</td>
</tr>
<tr>
<td>Telephone</td>
<td></td>
<td>360</td>
</tr>
<tr>
<td>Insurance</td>
<td></td>
<td>600</td>
</tr>
<tr>
<td>Utilities</td>
<td></td>
<td>900</td>
</tr>
<tr>
<td>Advertising</td>
<td></td>
<td>1,200</td>
</tr>
<tr>
<td>Supplies</td>
<td></td>
<td>600</td>
</tr>
<tr>
<td>Acc/Legal</td>
<td></td>
<td>1,200</td>
</tr>
<tr>
<td>Outside Serv</td>
<td></td>
<td>3,600</td>
</tr>
<tr>
<td>Depreciation</td>
<td></td>
<td>3,000</td>
</tr>
<tr>
<td>Total Expenses</td>
<td></td>
<td>(27,060)</td>
</tr>
<tr>
<td>Operating Income</td>
<td></td>
<td>13,260</td>
</tr>
</tbody>
</table>

You will notice that the income statement above lists depreciation of $3,000. This is the current depreciation of whatever assets we are depreciating. This is NOT the accumulated depreciation. Therefore, if you are using the straight line depreciation method, the current depreciation of the same assets will be the same amount of money on successive income statements.
You will also notice that the income statement does NOT identify the value of the assets being depreciated, and it does NOT list as an expense the purchase price of those assets. Only the operating expenses are listed as an expense on the income statement.

Once we determine the operating income in our company, we can also add in any other income we may receive from sources that are not our primary business. This could include interest income, rental income (if that is not our primary business), sales of assets (which is not our primary business), and any other income. We can subtract interest payments (either as an operating expense, or we can list it as a line item under operating income) and also we can subtract our taxes.

4. Statement of Owner’s Equity

Now that we have prepared our income statement, we can prepare our statement of owner’s equity. To prepare our statement of owner’s equity, we need to know our beginning equity. In a new business, our beginning equity is the amount of owner’s investment in the business. In an existing business, beginning equity is equal to last year’s ending equity.

EXAMPLE: We start a new business with an investment of $50,000 cash and 800 units of inventory worth $2/unit. Our beginning equity is the value of the cash and the inventory which is $50,000 + (800 x 2) = 51,600. To our beginning inventory, we add our net income (or subtract our loss) which we get from our income statement. Using the previous income statement, our net income is $13,260. From our net income we will subtract withdrawals. If we were to assume we took an owner’s draw of $1,000/month, we will subtract $12,000. (Please note that the draws are not shown on the income statement). The remaining balance is our owner’s equity.

The example above assumed a sole proprietorship in its first year of operation. However, what if the business were an already established corporation. The Statement of Owner’s Equity would instead be a statement of shareholder’s equity, and would reflect the retained earnings of the corporation.

Retained earnings are the earnings of the corporation which are left in the corporation rather than being distributed to the shareholders. For example, let us assume that in its second year of operation, our business had a net loss of $4,237. The following year, the corporation would have beginning retained earnings of -$4,237. This would be increased by the net income of that ensuing year (or further decreased by a net loss) and decreased by any dividends paid that year. If we were to assume that our company had a net income of 43,181, and paid dividends of 30,400, our statement of retained earnings would look like
Having calculated our retained earnings, and assuming that the common stock of our corporation was initially sold for $44,402, our statement of shareholder’s equity would look like this:

**Statement of Retained Earnings**

<table>
<thead>
<tr>
<th>Sample Company</th>
<th>For the Year Ended 12/31/13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retained Earnings, January 1, 2013</td>
<td>(4,237)</td>
</tr>
<tr>
<td><strong>Net Income for 2013</strong></td>
<td>43,181</td>
</tr>
<tr>
<td><strong>Less Dividends for 2013</strong></td>
<td>(30,400)</td>
</tr>
<tr>
<td><strong>Net Increase in Retained Earnings</strong></td>
<td>12,781</td>
</tr>
<tr>
<td>Retained Earnings, December 31, 2013</td>
<td>8,544</td>
</tr>
</tbody>
</table>

5. **Cash Flow Statement**

The statement of cash flow is like a checkbook register. It will show actual money coming in to the business, and actual money being spent. Using the fact pattern from our previous example, we started the business with $50,000 cash. We had net revenue of $53,760, which we can get from our income statement, and which represents our cash sales. (If not all of our sales are for cash, then we will have to subtract out the receivables when we prepare our statement of cash flow). Our income statement shows operating expenses of $27,060, but this includes our depreciation expense of $3,000 (which is not actual money we are paying someone), so we have to back that out of our expenses. Therefore, we have cash operating expenses of $24,060. We took the cash draw for the year of $12,000. Also, we are depreciating an asset, so we must have bought that asset. The purchase price of the asset does not show on the income statement, so don’t forget to include it on your statement of cash flow. We will assume that the asset we purchased was a truck, and its cost was $15,000, for which we paid cash. Also, we purchased inventory throughout the year. Remember, our inventory cost was not included in operating expenses. Given the foregoing, our statement of cash flow should look like this:
Now that we have completed our income statement and statement of cash flow, we can prepare the balance sheet. A balance sheet follows this simple formula: Assets = Liabilities + Owner’s Equity.

Our assets will be divided into two categories: current assets and fixed assets. Current assets are those assets which are easily convertible to cash within the year, and could include cash, accounts receivable, and inventory. Fixed assets are more difficult to convert to cash. They will include longer term investments such as vehicles and land.

Like assets, liabilities will also be divided into two categories: Current liabilities and Long Term liabilities. Current liabilities are payable within the year, while long term liabilities includes debt which is payable over a period of more than one year.

Owner’s equity simply comes from the statement of owner’s equity. The statement of owner’s equity shown above is for a sole proprietorship, and therefore does not show the value of corporate stock or retained earnings as would the statement for a corporation.

If we were to use the facts from the examples above, our sample balance sheet would look like this:

<table>
<thead>
<tr>
<th>Cash Flow for Period Ending 12/31/10</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Beginning Balance</strong></td>
</tr>
<tr>
<td><strong>Cash Sales</strong></td>
</tr>
<tr>
<td><strong>Operating Expenses</strong></td>
</tr>
<tr>
<td><strong>Inventory</strong></td>
</tr>
<tr>
<td><strong>Truck</strong></td>
</tr>
<tr>
<td><strong>Owner’s Draw</strong></td>
</tr>
<tr>
<td><strong>Ending Balance</strong></td>
</tr>
</tbody>
</table>
You will notice that the cash and inventory is listed before the truck in our list of assets as the cash and inventory are current assets while the truck is a fixed asset. Also, remember, the fixed assets will probably be depreciated. Since we just bought the truck this year, its accumulated depreciation is the same as its current depreciation. However, next year, the current depreciation as shown on the income statement will still be $3,000, but the accumulated depreciation as shown on the balance sheet will be $6,000.

Please note that both sides of the balance sheet must BALANCE. Therefore, the total assets of $52,860 must equal the total liability + owner’s equity.

Finally, the above balance sheet shows the assets, liabilities, and owner’s equity of a sole proprietorship. If, instead, our business were a corporation, our balance sheet would have to include both shareholder’s equity (instead of owner’s equity) and would reflect our retained earnings.

Assuming we are in year three of an existing corporation, a sample balance sheet could look like the following:

<table>
<thead>
<tr>
<th>Balance Sheet</th>
<th>Sample Company</th>
<th>December 31, 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Assets</td>
<td>Liabilities</td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>40,700</td>
</tr>
<tr>
<td>Inventory</td>
<td></td>
<td>160</td>
</tr>
<tr>
<td>Truck</td>
<td>15,000</td>
<td>Less Acc. Dep</td>
</tr>
<tr>
<td></td>
<td>(3,000)</td>
<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td>52,860</td>
<td>Total Liability + Owner’s Equity</td>
</tr>
</tbody>
</table>
7. **Loan Amortization**

It is conceivable that part of your capital will come from loans. If that is the case, interest and principal paid will factor into your financial statements. Determining how much principal and interest will be paid for a specific time period is simple, and can be calculated using Excel templates.

You will need to determine the total loan, interest rate, and term of the loan. Once you have this information, you can easily calculate monthly payments, as well as determine how much interest and how much principal will be paid for any specific time period.
The loan amortization template in Excel is shown below:

### Loan Amortization Schedule

<table>
<thead>
<tr>
<th>Loan Amount</th>
<th>Payment Date</th>
<th>Beginning Balance</th>
<th>Scheduled Payment</th>
<th>Extra Payment</th>
<th>Total Payment</th>
<th>Principal</th>
<th>Interest</th>
<th>Ending Balance</th>
<th>Cumulative Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1/1/2012</td>
<td>$100,000.00</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$1,130.99</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$69,263.41</td>
<td>$334.33</td>
</tr>
<tr>
<td>2</td>
<td>2/1/2012</td>
<td>$97,263.41</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$1,130.99</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$66,146.02</td>
<td>$367.66</td>
</tr>
<tr>
<td>3</td>
<td>3/1/2012</td>
<td>$94,146.02</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$1,130.99</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$63,301.61</td>
<td>$391.00</td>
</tr>
<tr>
<td>4</td>
<td>4/1/2012</td>
<td>$91,301.61</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$1,130.99</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$60,766.00</td>
<td>$414.33</td>
</tr>
<tr>
<td>5</td>
<td>5/1/2012</td>
<td>$88,766.00</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$1,130.99</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$58,430.21</td>
<td>$437.66</td>
</tr>
<tr>
<td>6</td>
<td>6/1/2012</td>
<td>$86,430.21</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$1,130.99</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$56,395.20</td>
<td>$461.00</td>
</tr>
<tr>
<td>7</td>
<td>7/1/2012</td>
<td>$84,395.20</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$1,130.99</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$54,559.90</td>
<td>$484.33</td>
</tr>
<tr>
<td>8</td>
<td>8/1/2012</td>
<td>$82,659.90</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$1,130.99</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$52,914.60</td>
<td>$507.66</td>
</tr>
<tr>
<td>9</td>
<td>9/1/2012</td>
<td>$81,144.61</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$1,130.99</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$51,478.79</td>
<td>$531.00</td>
</tr>
<tr>
<td>10</td>
<td>10/1/2012</td>
<td>$79,878.79</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$1,130.99</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$49,253.80</td>
<td>$554.33</td>
</tr>
<tr>
<td>11</td>
<td>11/1/2012</td>
<td>$78,753.90</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$1,130.99</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$47,128.99</td>
<td>$577.66</td>
</tr>
<tr>
<td>12</td>
<td>12/1/2012</td>
<td>$77,723.31</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$1,130.99</td>
<td>$796.69</td>
<td>$334.33</td>
<td>$45,193.09</td>
<td>$601.00</td>
</tr>
</tbody>
</table>

As assuming a 15-year $1,000,000 loan at 4% interest from fictional First Bank of America:
Break-Even Analysis

A company breaks even when its total sales equals its total expenses. To calculate the break-even point, one must know not only a firm’s total expenses, but of those expenses, how much are fixed and how much are variable.

Fixed expenses are those which will be incurred regardless of the amount of sales. Variable expenses, on the other hand, vary depending on the amount of sales. As sales increase, variable expenses may also increase, and as sales decrease, variable expenses also decrease. One primary example of a variable expense is the cost of inventory.

The formula to calculate the break-even point in units for a single product is:

\[ \frac{\text{Fixed Costs}}{\text{unit selling price} - \text{unit variable cost}} \]

The formula to calculate the break-even point in dollars for a single product is:

\[ \frac{\text{Fixed Costs}}{\text{Contribution Margin Ratio}} \]

The contribution margin ratio = \( \frac{\text{Contribution margin}}{\text{unit sales price}} \)

The contribution margin = \( \text{Unit sales price} - \text{unit variable cost} \)

This calculation tells you how much you need to sell before you stop losing money. Once you have reached this point, you have recovered all costs associated with selling your product. This is not the payback period. In other words, this calculation does not tell you when you will recover your initial investment in the firm.

EXAMPLE: Let’s assume we are selling a product for $5. It has a variable unit cost of $2.5 and we have fixed costs of $500.

1. The contribution margin = unit sales price - unit variable cost = 5 - 2.5 = 2.5
2. The contribution margin ratio = contribution margin/unit sales price = 2.5/5 = 50%
3. The break-even point in $ = \( \frac{\text{Fixed costs}}{\text{Contribution margin ratio}} \) = 500/50% = 1,000

This means we have to sell $1,000 worth of goods to meet our expenses.

The break-even point can be expressed graphically as follows:
If your company sells multiple products or services, you will need to conduct the multiple product break-even analysis. To account for multiple products, we will modify our formula to reflect the proportion of sales each product represents.

Our break-even point in dollars = Fixed Cost ÷ Weighted Contribution Margin Ratio.

EXAMPLE: Let’s assume we have fixed costs of $211,220, and we sell three products with the following sales forecast:

<table>
<thead>
<tr>
<th>Item</th>
<th>Price</th>
<th>Variable Cost</th>
<th>Sales Forecast Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>8.50</td>
<td>3.41</td>
<td>48,000</td>
</tr>
<tr>
<td>B</td>
<td>6.00</td>
<td>1.98</td>
<td>36,000</td>
</tr>
<tr>
<td>C</td>
<td>3.00</td>
<td>0.74</td>
<td>96,000</td>
</tr>
</tbody>
</table>

To calculate our break-even point, we determine not only the contribution margin and contribution margin ratio for each product, but also its percent of sales so that we can appropriately weight the contribution margin ratio. The following table illustrates this process:

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
</tr>
</thead>
<tbody>
<tr>
<td>Item</td>
<td>Price</td>
<td>Var. Cost</td>
<td>Cont Mar</td>
<td>CMR</td>
<td>Sales in $</td>
<td>% Sales</td>
<td>W = 5x7</td>
</tr>
<tr>
<td>A</td>
<td>8.50</td>
<td>3.41</td>
<td>5.09</td>
<td>60%</td>
<td>408,000</td>
<td>.44</td>
<td>.264</td>
</tr>
<tr>
<td>B</td>
<td>6.00</td>
<td>1.98</td>
<td>4.02</td>
<td>67%</td>
<td>216,000</td>
<td>.24</td>
<td>.161</td>
</tr>
<tr>
<td>C</td>
<td>3.00</td>
<td>0.74</td>
<td>2.26</td>
<td>75%</td>
<td>288,000</td>
<td>.32</td>
<td>.240</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>912,000</td>
<td>1.000</td>
<td>.665</td>
</tr>
</tbody>
</table>

Column 1 represents each different item we sell
Column 2 shows the price we sell each item for
Column 3 is the per unit variable cost for each item
Column 4 is the contribution margin for each item, calculated by subtracting the variable cost (column 2) from the sales price of the item (column 1)
Column 5 is the contribution margin ratio for each item calculated by dividing the contribution margin (column 4) by the item’s sales price (column 2)
Column 6 shows total sales in dollars. This is calculated by multiplying the sales forecast for each item by its sales price. Once each item’s annual sales is calculated, we add these up for total annual sales.
Column 7 shows what percentage of sales each item represents. This number is calculated by dividing the individual sales figure for each item (column 6) by total annual sales of all items. You will not that the percentage of sales of all three items adds up to 100%
Column 8 gives us the weighted contribution margin, which is calculated by multiplying each item’s contribution margin ratio with its percent of sales (column 5 x column 7). These individual weights are
added together to give us the total weighted contribution margin ratio. In our example, the weighted contribution margin ratio is .665.

Our break-even point in dollars is the Fixed costs ÷ the weighted contribution margin ratio = 211,220 ÷ .665 = $317,624.

This tells us that we have to achieve $312,624 in sales to break-even. Our break-even point can be illustrated as follows:
Ratio Analysis

An important part of your business plan is your ratio analysis. This analysis assists you in determining the health and viability of your business. Your ratios should be compared over time. Therefore, you should conduct your ratio analysis for each of the years your business plan covers, and then explain what these numbers mean.

1. Liquidity Ratios

The first group of ratios to be analyzed are your liquidity ratios. These ratios analyze the amount of cash available to cover both long term and current expenses. Without sufficient liquidity, lenders may not lend you money at favorable rates, or at all. Likewise, investors may not feel secure enough to invest in your firm. Additionally, suppliers may not be willing to extend to you favorable credit or terms of sale if they do not believe they are likely to be paid.

   a. Current Ratio

   The current ratio measures a firm’s ability to meet short term obligations. Generally, current assets should be 2 times (or 200%) or current liabilities. A company with a low ratio may not be able to pay its bills on time (or at all). A company with a high ratio means the company can pay its bills, but too high of a ratio might suggest that the company is not utilizing its assets efficiently. Instead, it may have too many assets tied up in low-yielding investments. The proper ratio for a business depends on its industry. Your business plan should not only calculate your current ratio over time, but should also explain how it compares to industry average.

   The current ratio is calculated as follows: current assets ÷ current liabilities. These numbers are taken from your balance sheet.

   b. Quick Ratio (Acid Test)

   The quick ratio is a variation of the current ratio. In the quick ratio, only cash and accounts receivable are included in the formula. The current assets in the quick ratio would exclude the inventory. Moreover, some analysts decrease accounts receivable by 25%. Whether you do or not depends on how strongly you believe in your ability to fully collect your receivables. In general, one would hope for a quick ratio of 1:1.

   The quick ratio is calculated as follows: (cash + a/r) ÷ current liabilities

   c. Turnover of Cash Ratio

   This ratio measures your turnover of cash, or working capital. Working capital is defined as current assets - current liabilities. Generally accepted standards are 5 to 6 times working capital. A low ratio may mean your funds are tied up in short-term, low-yielding assets. A high ratio may mean you are not able to pay your bills on time, and are vulnerable to creditors.
The turnover of cash ratio is calculated as follows: net sales ÷ working capital

d. Debt to Equity Ratio

This ratio measures the relationship between cash invested by creditors (such as bank loans) and the owner’s equity in the business. Some feel that current liabilities to net worth should not exceed 80% and long-term debt to net worth should not exceed 50%. A low ratio may mean long-term financial stability. However, too low a ratio might suggest that current management is too fiscally conservative. A high ratio means that the firm is at risk to creditors.

Debt to Equity Ratio is calculated as follows: total debt ÷ total equity

2. Profitability Ratios

These ratios allow you to measure the profitability of your business. For example, if you could earn more in a savings account than investing that same amount in your business, your money is better invested elsewhere.

a. Rate of Return on Sales

This ratio measures how much operating income is derived from every dollar of sales. It indicates how well you are managing your operating expenses. The generally accepted standard varies based on the industry. A low ratio may not mean much in some industries, but usually, the higher the ratio the better.

Rate of Return on Sales is measured as follows: operating income ÷ net sales

b. Rate of Return on Assets

This ratio measures how much operating income is derived from every dollar of assets. It indicates how well you are managing your assets. A low ratio may mean poor performance or inefficient use of assets by management. A high ratio may show good performance or efficient use of assets by management.

Rate of Return on Assets is measured as follows: income before taxes ÷ total assets

c. Rate of Return on Investments

This ratio measures the owner’s return on investment (ROI). This ratio is considered one of the best indicators of profitability, and some investors may use this as the final evaluator when determining whether or not to invest in a company. This ratio is also know as rate of return on equity (ROE). ROI of 15% is generally deemed necessary to fund future growth from within the business. A low ratio may mean money is better invested elsewhere. A high ratio may mean that creditors where a large source of investment, management is efficient, or the firm is undercapitalized.

Rate of Return on Investments = income before taxes ÷ net worth

An alternate method of calculation is as follows:

Rate of Return on Investments = EBIT ÷ net worth (where EBIT is earnings before interest and
3. Efficiency Ratios

Efficiency ratios measure the efficiency of management. They provide a measurement for how fast you are collecting your money for credit sales, and how many times you are turning over your inventory in a given time period.

a. Average Collection Period Ratio

This measures the average number of days it takes to collect cash from credit sales. A low ratio means quick collection which could be the result of stringent collection procedures. A high ratio means collection is slow. This could be the result of a large number of bad accounts, too much credit is being issued, or loose collection procedures are in place. Generally accepted standard is 10 to 15 days.

\[
\text{Average collection period ratio} = \frac{\text{accounts receivable \times days in the year}}{\text{net sales}}
\]

b. Inventory Turnover Ratio

This ratio measures the amount of times inventory is replaced in a given time period. 6 to 7 times is a rule of thumb, but it is also contingent upon the industry. A low ratio may mean you have a large inventory, while a high ratio may mean you have fast moving inventory. Too high an inventory turnover ratio may mean that you are losing sales due to not having enough inventory.

\[
\text{Inventory turnover ratio} = \frac{\text{COGS}}{\text{Average Inventory}}
\]

Average inventory can be calculated as follows: \((\text{beginning inventory} + \text{ending inventory}) ÷ 2\)

c. Fixed Asset Turnover Ratio

This ratio measures management’s effectiveness in generating sales from investments in fixed assets. The generally accepted standard is 3 to 5 times. A higher ratio suggests less need for investment in fixed assets to generate sales, which increases profitability. A lower ratio suggests more dependence on fixed assets to generate sales, and therefore increases costs. It could also suggest that existing assets are not fully employed.

\[
\text{Fixed Asset Turnover Ratio} = \frac{\text{net sales}}{\text{fixed assets}}
\]

4. Other Profitability Measures

While not ratios, the following are additional measures one can use to gauge the profitability of a business:

a. Average Rate of Return (ARR)

Average rate of return measures the profitability of a business or a project by comparing net earnings to the business’s or project’s initial costs.
ARR = average annual future returns ÷ ½ (initial investment)

EXAMPLE: Earnings for the next four years are estimated to be $10,000, $15,000, $20,000, and $30,000, respectively. If the initial investment is $100,000, the ARR can be calculated as follows: \[
\frac{(10,000 + 15,000 + 20,000 + 30,000)}{4} \div \frac{1}{2} (100,000) = 18,750 \div 50,000 \approx 38\%
\]

b. Payback Period

The payback period measures the amount of time required to recover one’s initial investment. To calculate the payback period, one will determine how long it will take for the sum of the regular cash flows to equal the initial investment.

EXAMPLE: Assume we have an initial investment of $3,700, and estimated regular cash flows of $1,000 in year 1, $2,000 in year 2, $1,500 in year 3, and $1,000 in year 4. Payback will be calculated as follows:

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Regular Cash Flow</th>
<th>Running Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1\textsuperscript{st} year</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>2\textsuperscript{nd} year</td>
<td>2,000</td>
<td>3,000</td>
</tr>
</tbody>
</table>

At the end of year two, we have recovered 3,000 of our initial investment of $3,700, leaving a difference of $700 which has yet to be recovered. Since our year three cash flow of $1,500 is greater than the $700 we still need to recover, we know that our payback will occur some time in year 3. If we know the monthly cash flow for year three, we can determine our payback of the final $700 with greater accuracy. However, if we only know the annual cash flow, we might assume that the cash flow of $1,500 in year three was earned evenly over the year. Given that 700 is 47% of 1,500, and 47% of one year is approximately 24 weeks, we know that our payback will occur in 2 years and 24 weeks.

Calculating payback period on excel is simple. Assume your initial investment is 800,000, your year 1 cash flow is 200,000 and you anticipate growth of 3% annually. To calculate the payback period, define year 1 cash flow, growth and initial investment as ranges. This is done by typing in column B the values for these ranges, and while in these cells, type the range name in the name box and hit enter.

For annual cash flows, you will type in the formula box “-initial_investment” for year 0. This will automatically insert the initial investment. For year 1, type “+year_1_cash_flow” in the formula box. This will automatically insert year 1 cash flow. For ensuing year annual cash flow, type in the formula box =B6*(1+Growth). Using the small box in the lower right hand corner of the cell, you can copy this formula for each of the following years.
For cumulative cash flows, enter the formula B5 in the cell C5. For year 1, type in the formula box =C5+ B6. Using the small box in the lower right hand corner of the cell, you can drag this formula down to each of the ensuing years. Your payback period is the first year in which your cumulative cash flow is positive.

\[
\begin{array}{cccc}
\text{A} & \text{B} & \text{C} & \text{D} \\
1 & \text{Year 1 cash flow} & 200,000 & \\
2 & \text{Growth} & 0.03 & \\
3 & \text{Initial Investment} & 800,000 & \\
4 & \text{Year} & \text{Annual Cash Flow} & \text{Cumulative Cash Flow} \\
5 & 0 & -800,000 & -800,000 \\
6 & 1 & 200,000 & -600,000 \\
7 & 2 & 206,000 & -394,000 \\
8 & 3 & 212,180 & -181,820 \\
9 & 4 & 218,545.4 & 36,725 \\
10 & 5 & 225,101.762 & 261,827 \\
11 & 6 & 231,854.8149 & 493,682 \\
12 & 7 & 238,810.4593 & 732,492 \\
13 & 8 & 245,974.7731 & 978,467 \\
\end{array}
\]

c. Net Present Value (NPV)

Given, that money in hand has a greater value than the same amount of money to be received in the future, we can gauge the profitability of an investment as compared to alternative uses for the funds by calculating net present value. If the present value of a project’s future cash flow is greater than its initial cost, the project may be worth undertaking. Since we are determining whether this investment is a better use of our money than some other investment, we must first determine the appropriate discount rate to use. The discount rate represents the rate we could have received had we invested our money elsewhere. To calculate net present value, we first select our discount rate, and then consult the present value interest factor table to identify the present value interest factors for the years in question. Multiplying our cash flow by its relevant present value interest factor, and adding up the resulting present values of those cash flows, we will determine the present value of the projects total cash flows. Subtracting from that number our initial investment gives us the net present value. If the net present value is positive, then the investment would have been worthwhile, but if the net present value is negative, then the project should probably be rejected.

EXAMPLE: ABC company is considering an investment that will provide annual after-tax cash flows of $6,000, $4,000, $3,000, and $2,000, respectively, for four years. Assuming a discount rate of 10% and an initial investment of $9,000, the net present value can be calculated as follows:

\[
\begin{array}{cccc}
\text{Year} & \text{Cash Flow} & \times & \text{PVIF} & \text{Present Value} \\
1 & 6,000 & \times & .909 & 5,454 \\
2 & 4,000 & \times & .826 & 3,304 \\
3 & 3,000 & \times & .751 & 2,253 \\
4 & 2,000 & \times & .683 & 1,366 \\
\end{array}
\]
The sum of the present values is: 5,454 + 3,304 + 2,253 + 1,366 = $12,377

Subtract the initial outlay from the sum of the present values for our net present value: 12,377 - 9,000 = $3,377.

Since our net present value is positive, this was a good investment, and the project should be accepted.

d. Profitability Index (PI)

The profitability index compares the present value of future cash inflows (PVCF) with the initial investment on a relative basis. The profitability index is calculated by dividing the PVCF by the initial investment. Again, one must determine an appropriate discount rate.

\[
\text{PI} = \frac{\text{PVCF}}{\text{Initial Investment}}
\]

A project with a PI of less than one would be rejected and a project with a PI of greater than one would be accepted.

EXAMPLE: A company is considering a project with projected annual cash flows of $5,000, $3,000, and $4,000, respectively, for the next three years. The initial investment is $10,000. Assume a discount rate of 12%. The profitability index would be calculated as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Cash Flow</th>
<th>x</th>
<th>PVIF</th>
<th>Present Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>5,000</td>
<td>x</td>
<td>.893</td>
<td>4,465</td>
</tr>
<tr>
<td>2</td>
<td>3,000</td>
<td>x</td>
<td>.797</td>
<td>2,391</td>
</tr>
<tr>
<td>3</td>
<td>4,000</td>
<td>x</td>
<td>.712</td>
<td>2,848</td>
</tr>
</tbody>
</table>

Adding the present values of 4,465 + 2,391 + 2,848, we get a total present value of $9,704.

\[
\text{PI} = \frac{\text{PVCF}}{\text{Initial investment}} = \frac{9,704}{10,000} = .9704.
\]

Since our profitability index is less than one, this project would be rejected.
Basic Vocabulary

ACCOUNTS PAYABLE is the total of all money owed by the company to a supplier for goods and services received but not yet paid. This includes rent, utilities, office supplies and materials that are used to make goods for sale or are to be resold as they were received.

ACCOUNTS RECEIVABLE is money owed to a company for goods sold or services performed but not yet collected.

ACCRUAL BASIS OF ACCOUNTING is a method wherein revenue and expenses are recorded in the period in which they are earned or incurred regardless of whether cash is received or disbursed in that period. This is the accounting basis that generally is required to be used in order to conform to generally accepted accounting principles (GAAP) in preparing financial statements for external users.

ACCRUED ASSETS are assets from revenues earned but not yet received.

ACCRUED EXPENSES are expenses incurred during an accounting period for which payment is postponed.

ACCRUED INCOME is income earned during a fiscal period but not paid by the end of the period.

ACCRUED INTEREST is interest earned but not paid since the last due date.

ACCRUED LIABILITIES are liabilities which are incurred, but for which payment is not yet made, during a given accounting period. Some examples in a manufacturing environment would be: wages, taxes, suppliers/vendors, etc.

ASSET is anything owned by an individual or a business, which has commercial or exchange value. Assets may consist of specific property or claims against others, in contrast to obligations due others.

BALANCE SHEET is an itemized statement that lists the total assets and the total liabilities of a given business to portray its net worth at a given moment of time. The amounts shown on a balance sheet are generally the historic cost of items and not their current values.

BOTTOM LINE, in accounting/finance, is specifically net income after taxes. In general, it is an expression as to the end results of something, e.g. the net worth of a corporation on a balance sheet, sales generated from a marketing campaign, or final decision on most any subject (Often said: “give me the bottom line”).

BRAND NAME is a brand identifier that can be spelled and spoken.

BRANDING is the process of establishing the elements of a brand, including its name, identifying symbols and related marketing messages.

BRAND is any name, symbol or other identifier used individually or in combination to identify the goods and/or services of a seller and differentiate them, on any tangible or intangible basis, from similar goods and/or services of competitors.
BREAK-EVEN ANALYSIS is an analysis method used to determine the number of jobs or products that need to be sold to reach a break-even point in a business.

BREAK-EVEN POINT is the volume point at which revenues and costs are equal; a combination of sales and costs that will yield a no profit/no loss operation.

BUDGET is an itemized listing of the amount of all estimated revenue which a given business anticipates receiving, along with a listing of the amount of all estimated costs and expenses that will be incurred in obtaining the above mentioned income during a given period of time. A budget is typically for one business cycle, such as a year, or for several cycles (such as a five year capital budget).

BURN RATE is the rate at which a new company uses up its venture capital to finance overhead before generating positive cash flow from operations. It is the rate of negative cash flow, usually quoted as a monthly rate.

CASH BASIS OF ACCOUNTING is the accounting basis in which revenue and expenses are recorded in the period they are actually received or expended in cash. Use of the cash basis generally is not considered to be in conformity with generally accepted accounting principles (GAAP) and is therefore used only in selected situations, such as for very small businesses and (when permitted) for income tax reporting. See also Accrual Basis.

CASH FLOW is the amount of money which flows in and out of a business, the difference between the two being the important number. If more money flows into a business than out of it, it is cash positive. If more money flows out than in, it is cash negative.

CASH AND EQUIVALENTS is the value of assets that can be converted into cash immediately, as reported by a company. Usually includes bank accounts and marketable securities, such as government bonds and bankers' acceptances. Cash equivalents on balance sheets include securities that mature within ninety days.

COMMON STOCK represent a voting ownership interest in a company given to investors in exchange for money or something of value.

COST OF GOODS SOLD (COGS) is a figure representing the cost of buying raw material and producing finished goods. Included are precise factors, i.e. material and factory labor; as well as others that are variable, such as factory overhead.

CURRENT ASSETS are those assets of a company that are reasonably expected to be realized in cash, or sold, or consumed during the normal operating cycle of the business (usually one year). Such assets include cash, accounts receivable and money due usually within one year, short-term investments, US government bonds, inventories, and prepaid expenses.

CURRENT LIABILITIES are debts owed by a company which are due for settlement within 12 months. These include creditors and taxes due etc.

CURRENT CASH DEBT RATIO measures ability to pay current liabilities in given year with cash derived from operating activities. Calculated using net cash from operating activities divided by average current liabilities.
DEPRECIATION is the charge in a company's accounts which reflects the reduction in value of an asset over time as its useable life is exhausted.

FIXED ASSETS are land, building equipment, fixtures, machinery, tools, furniture, office devices, patterns, drawings, less accumulated depreciation

GROSS PROFIT is net sales minus cost of sales. It is also called gross margin.

GROSS PROFIT MARGIN ON SALES (GPM) is one of the key performance indicators. The gross profit margin gives an indication on whether the average markup on goods and services is sufficient to cover expenses and make a profit. GPM shows the relationship between sales and the direct cost of products/services sold. It measures the ability of both to control costs and to pass along price increases through sales to customers. The gross profit margin should be stable over time. A persistent gradual decrease is likely to indicate that productivity needs to be increased to return profitability back to previous levels.

GROSS RECEIPTS is the total amount received prior to the deduction of any allowances, discounts, credits, etc.

INVENTORY: For manufacturers it is the sum of finished merchandise on hand, raw materials and material in process. For retailers and wholesalers it is the stock of salable goods on hand.

LIABILITY, in accounting, is a loan, expense, or any other form of claim on the assets of an entity that must be paid or otherwise honored by that entity.

LONG TERM DEBT are all the obligations, such as mortgages, bonds, term loans, and any other money that comes due more than one year from the date of the statement.

MARKET POSITIONING refers to the user's perceptions of the place a product or brand occupies in a market segment. Or how the company/library's offering is differentiated from the competition's.

MARKET SHARE is a proportion of the total sales/use in a market obtained by a given facility or chain.

MARKET OPPORTUNITY is an attractive arena of relevant marketing action in which a particular organization is likely to enjoy a superior and competitive advantage.

MARKETING PLAN is a document composed of an analysis of the current marketing situation, opportunities and threats, analysis, marketing objectives, marketing strategy, action programs, and projected income statement.

MORTGAGE is a legal document that pledges property to cover a debt.

NET INCOME is the difference between a businesses total revenue and its total expenses. This caption and amount is usually found at the bottom of a company's Profit and Loss statement. Same as Net Profit.

NET PROFIT is the company's total earnings, reflecting revenues adjusted for costs of doing business,
depreciation, interest, taxes and other expenses. Same as Net Income.

NET WORTH is also called owner’s equity. It is the difference between assets and liabilities.

OPERATING EXPENSES are the expenses associated with running the business. They generally include rent, office supplies, utilities, overhead, etc.

OPERATING INCOME is the difference between gross profit and operating expenses.

POSITIONING is defining, within the minds of the market, a brand (corporate, product, or service) relative to the competition. It is the latter part of the definition -- i.e., relative to the competition -- that separates positioning from other marketing communications messages.

PRODUCT POSITIONING is the way users/consumers view competitive brands or types of products. This can be manipulated by the company.

PROFITABILITY is company's ability to generate revenues in excess of the costs incurred in producing those revenues.

RETAINED EARNINGS is income/profit left in the company from the company’s creation, less any amount paid out to owners as dividends/withdrawals.

SG&A refers to the indirect overhead costs contained within the Sales, General and Administrative expense/cost categories.

SHORT TERM DEBT is also called notes payable. It is money borrowed by a company which is to be paid back within the year.

SITUATION ANALYSIS (SWOT) is an examination of the internal factors of a company to identify strengths and weaknesses, and the external environment to identify opportunities and threats.

TRADEMARK is legal protection given to a brand name and/or logo.

WORKING CAPITAL is a company’s current assets (cash, debtors, work in progress) less its current liabilities (creditors, taxes due).
Useful Resources

US Chamber of Commerce: http://www.uschambersmallbusinessnation.com/toolkits/finance

Economic data at http://www.principalglobalindicators.org


Business cycle information: http://www.businesscycle.com/resources

Forms of Business Ownership:

SEC: http://www.sec.gov/edgarhp.htm

Sample Business Plans: http://www.bplans.com/

http://SBDCnet.org

Business Planning Financials: http://www.youtube.com/watch?v=MO358-VGuYE

California Demographic Information: http://dof.ca.gov/HTML/FS_DATA/profiles/pf_home.php


Mission Statements: http://www.missionstatements.com

SWOT analysis: http://mystrategicplan.com/resources/topic/swot-analysis/

NAICS: http://www.census.gov/eos/www/naics/

Competitive Advantage: http://mystrategicplan.com/resources/competitive-advantage-2/

National Bureau of Economic Research: http://nbre.org/releases/

SCORE Small Business Resource Links: http://www.score.org/small_biz_power_links.html

University of Central Florida: http://www.libguides.lib.UCF.edu/content.php?pid=46314&sid=341889

Writing a Business Plan: http://www.uschambersmallbusinessnation.com/toolkits/guide/P02_5001

Dun & Bradstreet: http://www.zapdata.com

Center for Business Planning: http://www.businessplans.org/directory.html

Hoovers Online: http://www.hoovers.com
Three Methods of Sales Forecasting:
http://sbinfocanada.about.com/od/cashflowmgt/a/salesforecast.htm


Sales Forecasting for your Business:
http://sbinformation.about.com/od/businessplans/a/salesforecast.htm

Sales forecasting and Modeling:
http://www.decisionanalyst.com/services/Forecasting.dai?gclid=CO7Omo7Y9J4CFRT6agodI2E_mg

California Taxes: http://www.boe.ca.gov

Business Permits on CalGold: http://www.calgold.ca.gov/

Thomas Register: http://www.thomasnet.com


Thomas Regional: http://www.thomasregional.com

Valuation Resources: http://valuationresources.com/Reports/SIC5300RetailStores.htm

Thomas Global Register: http://www.tgnet.com

Bureau of Economic Analysis: http://www.bea.gov/industry/index.htm

Psychographics: http://www.claritas.com

How to Write a Mission Statement:
http://mystrategicplan.com/resources/how-to-write-a-mission-statement-that-inspires/

Demographics: http://www.easidemographics.com

How to Calculate Start-Up Expenses:
http://www.cabrillo.edu/~dambrosini/188Web/classsessions/startupcosts.htm

Strategic Planning: http://www.mystrategicplan.com


Trade Journals: http://www.allbusiness.tradepub.com/

Census Information: http://www.quickfacts.census.gov/qfd/index.html

Census Information: http://www.census.gov
ESRI:  http://www.esri.com/data/esri_data/demographic.html
California Corporate Tax Rates:  http://www.ftb.ca.gov/businesses/faq/717.shtml
Finance and Accounting:  http://www.alpineguild.com/how_to_keep_score_in_business.htm
Industry by Sector:  http://biz.yahoo.com/ic/ind_index.html
Global Trade Portal:  http://www.fita.org/
SBA:  http://www.sba.gov/training/
Government Data:  http://www.data.gov/
Strategic Management:  http://www.csuchico.edu/mgmt/strategy/
Strategic Planning:  http://www.planware.org/strategicplan.htm#1
Corporate Finance:  http://www.quickmba.com/finance/cf/
| INDEX |
|---------------------------------------------|----------------------|
| advertising                                | Page -12-, Page -42- |
| assumptions                                | Page -3-, Page -28-  |
| Average Rate of Return (ARR)               | Page -68-            |
| balance sheet                              | Page -2-, Page -51-, Page -59-, Page -60- |
| accrued liability                          | Page -25-            |
| asset                                      | Page -25-            |
| current assets                             | Page -51-, Page -59- |
| current liabilities                        | Page -51-, Page -59- |
| depreciation                               | Page -60-            |
| fixed assets                               | Page -51-, Page -59- |
| inventory                                  | Page -51-            |
| long-term debt                             | Page -51-, Page -59- |
| net worth                                  | Page -52-, Page -59- |
| S corporation                              | Page -27-            |
| Sales and Use Tax                          | Page -25-            |
| Barriers to Entry                          | Page -20-            |
| Board of Equalization                      | Page -25-, Page -26- |
| brand loyalty                              | Page -20-            |
| Break-Even Analysis                        | Page -63-            |
| contribution margin                        | Page -63-            |
| contribution margin ratio                  | Page -63-            |
| Fixed Costs                                | Page -63-            |
| Variable Costs                             | Page -63-            |
| Bureau of Economic Analysis                | Page -18-            |
| Bureau of Labor Statistics                 | Page -19-, Page -33- |
| Bureau of the Census                       | Page -19-, Page -49- |
| business license                           | Page -10-            |
| capital                                    | Page -13-            |
| Cash Budget Method                         | Page -13-            |
| cash flow                                  | Page -2-, Page -11-, Page -58- |
| Sales and Use Tax                          | Page -25-, Page -27- |
| Cash Turnover Method                       | Page -14-            |
| competitive advantage                      | Page -2-, Page -5-, Page -15-, Page -16-, Page -41- |
| Competitive Analysis                       | Page -34-, Page -35-, Page -37- |
| direct competitors                         | Page -34-            |
| indirect competitors                       | Page -34-            |
| core competencies                         | Page -4-, Page -5-   |
| Corporation                                | Page -22-, Page -24-, Page -57- |
| C Corporation                              | Page -21-            |
| dividend                                   | Page -57-            |
| retained earnings                          | Page -57-            |
| S corporation                              | Page -21-            |
| Cost of Goods Sold                         | Page -55-, Page -56- |
| inventory                                  | Page -55-            |
| Depreciation                               | Page -54-            |
| straight-line depreciation                  | Page -54-            |
employees............................................................ Page -9-, Page -33-
worker's compensation insurance................................... Page -33-
executive summary.................................................. Page -2-
fictitious business name............................................. Page -10-
Financial Ratios.................................................... Page -50-, Page -66-
Assets:Sales.......................................................... Page -50-
Average Collection Period Ratio.................................. Page -68-
Current Ratio....................................................... Page -50-, Page -66-
Debt to Equity Ratio................................................ Page -67-
Efficiency Ratios.................................................... Page -68-
Fixed Asset Turnover Ratio....................................... Page -68-
Inventory Turnover................................................ Page -50-, Page -68-
Liquidity Ratios..................................................... Page -66-
Profitability Ratios................................................ Page -67-
Quick Ratio.......................................................... Page -50-, Page -66-
Return on Assets................................................... Page -50-, Page -66-
Return on Net Worth............................................... Page -50-, Page -66-
Return on Sales..................................................... Page -50-, Page -66-
Total Liabilities:Net Worth........................................ Page -50-
Turnover of Cash Ratio............................................ Page -66-
Financial Statements............................................. Page -54-
balance sheet....................................................... Page -59-
cost of goods sold................................................ Page -55-
depreciation.......................................................... Page -54-
Income Statement.................................................. Page -56-
Sole Proprietorship................................................ Page -57-
Statement of Owner’s Equity...................................... Page -57-
GDP................................................................. Page -18-
imcome statement.................................................. Page -51-, Page -56-
cost of goods sold................................................ Page -51-, Page -55-, Page -56-
depreciation.......................................................... Page -51-, Page -56-
gross profit......................................................... Page -51-, Page -55-, Page -56-
Income Tax............................................................ Page -27-
interest............................................................... Page -51-, Page -57-
net profit............................................................. Page -51-
salaries and wages................................................ Page -51-
Sales and Use Tax.................................................. Page -25-, Page -27-
taxes................................................................. Page -51-, Page -57-
independent contractors............................................ Page -33-
Payroll............................................................... Page -33-
worker's compensation insurance............................... Page -33-
Industry Analysis................................................... Page -49-
demographics....................................................... Page -49-
insurance............................................................. Page -11-, Page -12-, Page -47-
Auto Insurance..................................................... Page -47-
Business interruption insurance................................ Page -47-
Health insurance.................................................. Page -47-
Key man insurance................................................ Page -47-
Structure of Business.

Corporation.

General Partnership.

LLC.

partnership.

sole proprietor.

Sole Proprietorship.

SWOT analysis.

core competencies.

target market.

demographics.

Segmentation.

taxes.

pass-through entity.

balance sheet.

Business Tax.

Income Tax.

LLC.

Payroll.

Real Property Tax.

Sales and Use Tax.

Self-Employment Tax.

Unsecured Property Tax.

Vehicle Tax.

working capital.