



# THE PLAN

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# A STEP-BY-STEP BUSINESS PLAN WORKBOOK

**The Plan**  
will help you:

- Move ideas from your head to paper in an organized, clear, convincing manner
- Avoid the most common mistakes
- Keep your focus on key points

COMPLIMENTS OF

*MasterCard* **Working**<sup>™</sup>  
FOR SMALL BUSINESS

# THE PLAN

## A STEP-BY-STEP BUSINESS PLAN WORKBOOK



### I N T R O D U C T I O N

Planning is your map to success in the business world. You need to write a business plan if you are:

- **starting or buying a business**
- **financing or refinancing your business**

Much money is made then lost because one area of a business failed, dragging the positive parts down with it.

**THE PLAN** helps you find hidden business flaws and makes you think carefully about each phase of your business.

It is important that **you** write your business plan. Why? You will gain in-depth knowledge about your business which will make it easy to answer lenders' questions. The process of writing your business plan will show you what is involved in making your business work successfully.

# How To Use This Workbook

*Break THE PLAN down into parts, to match the Contents section (see page 5). The length of answers you write will vary from one paragraph to a few pages. Use separate sheets of paper if your answers are longer than the space provided in this workbook. Your APPENDIX (see page 36--documents included at the end of THE PLAN) will grow and grow. It's a good idea to get an expandable file holder or a large envelope. Fill it with file folders so you can divide THE PLAN into sections and keep everything in its place.*



*The second stage is editing. Have other people critique your plan. Once the questions are answered, have your plan typed and bound by a local printer or copy shop. If you use a word processing program, make sure the information is formatted neatly.*

*Make copies for your lender and all interested people. Number the copies and make a list of who has your plan. On the inside cover, state that its contents are confidential, and you do not want copies made.*

# BUSINESS LOAN

## ASK YOURSELF THESE QUESTIONS:

- How much money do I need? \_\_\_\_\_
- What type of lender do I need? (*bank, state or federal agency, venture capitalist firm, or other investor*) \_\_\_\_\_
- What is the lender's minimum and maximum loan size? \_\_\_\_\_
- Can the lender meet my present and future needs? \_\_\_\_\_
- What types of businesses will the lender finance? \_\_\_\_\_
- What collateral does the lender accept? \_\_\_\_\_

## LENDERS USE THE EIGHT "C's" RULE:

1. Credit (*must be good*)
2. Capacity (*ability to repay*)
3. Capital (*money going into the business*)
4. Collateral (*your assets that secure the loan*)
5. Character (*you*)
6. Conditions (*economy, finances, anything that will affect your business*)
7. Commitment (*your ability and willingness to succeed*)
8. Cash Flow (*prove the business can support its debt and expenses*)

## BASIC QUESTIONS A LENDER WILL ASK YOU:

- How much do you want? \_\_\_\_\_
- How will the loan be used? \_\_\_\_\_
- How long will it take to repay the loan? \_\_\_\_\_
- How will the loan be repaid? \_\_\_\_\_
- What collateral do you have to offer? \_\_\_\_\_
- How much are you investing in the business? \_\_\_\_\_

## BEFORE MEETING WITH A LENDER:

- Call to find out the rules for business loans.
- Is the lender looking for loans of your size and type?
- Ask for a loan application to be sent to you.
- Make an appointment.
- Rehearse your presentation.
- Remember, your first customer is the lender! Before you sell anything, you have to first convince the lender that your business concept has merit.

# BASICS



## WHEN MEETING WITH A LENDER:

- Dress properly and be on time.
- Bring your business plan, a completed loan application, and any other materials you need.
- Be strong and positive.
- The entire presentation should take 30 minutes. Give an overview or outline at the beginning. Know how you are going to end the presentation.
- Ask your lender to take a tour of your current or proposed operation.
- Answer all negative questions with positive answers. Be willing to back up your answers and never lose your temper.
- Find out when you can expect an answer.
- Any decisions or negotiations made on the telephone should be put in writing.
- Follow up with a thank you letter and a phone call.
- Note: Generally, bankers like to simplify the process used to weed out loan requests having no merit from those warranting another look. The complexity or size of the loan request doesn't matter; the basic procedure is as simple as 1-2-3 (refer to the Ratios section on page 33).

## IF YOUR LOAN IS REJECTED:

Ask these questions to the lender who rejected your plan

- Why was I rejected? Get the reasons in writing.
- Does this mean I'm turned down? Or can I correct the problems and re-submit the plan?
- Should I go to another bank or lending institution?
- Should I seek alternative financing?
  - Which alternative? Why?
  - Who should I ask for? Why?
  - Should I tell the new lender the reason(s) for my rejection?

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# YOUR COVER LETTER

date \_\_\_\_\_  
your address \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Lender's name, bank name, and address

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Re: Financing Request

Dear (fill in lender's name) \_\_\_\_\_:

I (or we) am requesting a loan to \_\_\_\_\_. The owner(s), fill in names \_\_\_\_\_ have \_\_\_\_\_ experience in this industry (mention experience in industry or training that would qualify you to run this business).

The market for... (include one brief paragraph about the industry, its growth, and your target market/customers)

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

The competition includes.... (include one brief paragraph about your competition and why your business will attract their customers)

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

We request a \$ \_\_\_\_\_ loan for \_\_\_\_\_. I would like to repay your bank over \_\_\_\_\_ years. The source of repayment is from \_\_\_\_\_. My secondary source of repayment is from \_\_\_\_\_. My home and business assets are offered as collateral. Their equity value is \$ \_\_\_\_\_.

Attached is our business plan which backs up our request. If you have any questions, please contact me at (321)123-4567.

Sincerely,

(your signature and printed name here)

# BUSINESS DESCRIPTION

## Owners:

List each owner's name, business title, home address, telephone number, and social security number. Include a brief description of owners and managers (*experience and credentials in running the business*) and their ownership percentage of the business.

## Legal Business Description:

Sole proprietorship, partnership, limited liability, "C" or "S" corporation. List the state where the business is incorporated.

## Purpose:

Describe the intent of your business.

## Type of business:

Retail, wholesale, service, manufacturing, contracting, professional, importing/exporting.

## Industry:

Talk about what's going on in your industry, including economic trends, outlook, growth patterns and forecasts. Keep this section short. Explain more fully in the Marketing section (*pages 14-17*).

## Professional Relationships:

Include name, address, and telephone/fax numbers for your accountant, attorney, banker, insurance agent, and professional advisor(s).

### GENERAL

Name: MRJ Design  
Address: 21 Longwood Drive  
Toronto, Ontario, M5F 7G9  
Phone: (416) 123-4567 Fax: (416) 123-4789

### OWNERS

**Bob Smith:** 10 Brookfield Rd., Toronto, Ontario M9X 6Y9  
Phone: 416-456-7891 SIN: 367-897-088

Over 20 years of experience in creative management. Worked for several design firms. Mr. Smith owns 60% of the business.

**Linda Jones:** 96 Elm St., Toronto, Ontario M9X 6Y6  
Phone: 416-567-1234 SIN: 234-567-891

Ten years of experience as manager of large marketing communications department within Fortune 1000 corporation. Ms. Jones owns 40% of the business.

**Legal Status:** S Corporation

**Purpose:** Produce superior marketing communications material for other businesses.

**Status:** Start-Up. Will open December 2000

**Business Type:** Service

**Products/Services:** Graphic design, illustration, and artwork production. Other services, supplied by vendors/suppliers, include writing, photography, printing, and mailing services.

**Reasoning:** Both partners have over 30 years of industry experience that will be put to profitable use in our own firm. The demand for graphic communications is ...etc.

## General:

List the business name, location, mailing address, telephone and fax number.

## Business Status:

New/start up, ongoing, expansion, or buying a business. Include the date your business started or will start. *If buying a business, include a detailed business history in this section.*

**Reasons** for starting, buying, or expanding business.

### GOALS

**Current:** Bring to profitable status that will equal or exceed current income levels. Create relationships with clients. Build ...etc.

**Long-Term:** In four years, we will have 50-100 clients. Hire administrative person ... etc.

**Industry:** 100 design firms and designers exist in our territory. Advertising agencies (about 235) are also competitors but their specialty is not design. Many companies have relocated to Orlando so the demand for our services is growing. The number of start-up companies numbered 6000 last year...etc.

**Business Schedule:** Monday-Friday. 8:30-5:00. Open year round.

### PROFESSIONAL RELATIONSHIPS

#### Accountant:

Larry Stuart, CPA, 123 Main St., Toronto, Ontario, M9X 6Y9.  
Ph: 416-678-9012, Fax: 416-678-7890

#### Attorney:

Linda Johnson of Johnson and Smith, 456 Elm St., Toronto, Ontario, N7G 3S2. Ph: 416-234-5678, Fax: 416-345-6789

#### Banker:

John Nelson, Heritage Bank, 678 Oak St., Toronto, Ontario, N4D 2K9. Ph: 416-123-4567. Fax: 416-0987-6543.

#### Insurance Agent:

Linda Doe, Doe Insurance, 321 Grove Ave., Brampton, Ontario, F4D 6Y7. Ph: 416-432-7654. Fax: 416-876-5432

#### Professional Advisors:

Claire Velleca, Velleca Consultants, 1 Park St., Mississauga, Ontario, L9H 7X8. Ph: 416-222-1456, Fax: 416-419-1989

## Goals:

Include both current and long-term projections.

## Business Schedule:

Months, days, and hours your business will be open and in operation. Is the business seasonal? If so, show how you will adjust your time, schedule, inventory, and personnel.



## APPENDIX

Include resumes for owners and managers, detailed industry information, and seasonal business information.

# BUSINESS DESCRIPTION

**General**

Business name \_\_\_\_\_  
Location \_\_\_\_\_  
Mailing address \_\_\_\_\_  
E-mail address \_\_\_\_\_  
Telephone number \_\_\_\_\_ Fax number \_\_\_\_\_  
Tax Identification Number \_\_\_\_\_

**Owners.**

Provide the following information for each principal in the company.  
Name \_\_\_\_\_  
Business title \_\_\_\_\_  
Home address \_\_\_\_\_  
Telephone number \_\_\_\_\_  
Social security number \_\_\_\_\_

**Professional Relationships.** Include name, address, and telephone/fax numbers

Accountant \_\_\_\_\_  
\_\_\_\_\_  
Attorney \_\_\_\_\_  
\_\_\_\_\_  
Banker \_\_\_\_\_  
\_\_\_\_\_  
Insurance agent \_\_\_\_\_  
\_\_\_\_\_  
Professional advisor(s) \_\_\_\_\_  
\_\_\_\_\_

Include a brief description of owners and managers (*experience and credentials in running the business*) and their percentage of ownership

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Legal Business Description.** Sole proprietorship, partnership, corporation, or limited liability company. \_\_\_\_\_

**Type of business.** Retail, wholesale, service, manufacturing, contracting, professional, importing/exporting. \_\_\_\_\_

**Business Status.** New/start up, ongoing, expansion, or buying a business. \_\_\_\_\_

**Reasons** for starting, buying, or expanding business. \_\_\_\_\_

**Date** your business started or will start. \_\_\_\_\_ *If buying a business, include information here and refer to page 10.*

**Products and Services** \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Purpose.** Describe the intent of your business. \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Goals** Current goals (within the next year): \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Long-term (over the next five years): \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Industry.** What's going on in your industry. Include economic trends, outlook, growth patterns and forecasts. Keep this section short.  
\_\_\_\_\_  
\_\_\_\_\_

**Business Schedule.**  
Months, days, and hours your business will be open/in operation. \_\_\_\_\_

# BUYING A BUSINESS

## Questions that need answers

- Who started the business? When? \_\_\_\_\_  
\_\_\_\_\_
- Why is the business for sale? \_\_\_\_\_  
\_\_\_\_\_
- What is the history of the business? \_\_\_\_\_  
\_\_\_\_\_
- What is the price? How was it determined? \_\_\_\_\_  
\_\_\_\_\_
- What assets are you buying? *If available, include appraised values of the building, inventory, equipment as well as patents and trademarks in the Appendix. Compare the appraised value of all assets to the purchase price.* \_\_\_\_\_  
\_\_\_\_\_

### GLASS BOTTLE RECYCLING COMPANY

Paper Bottle Recycling Company started in June 1988 by the Smith family, the present owners. Mr. John Smith has a serious illness and can no longer manage the business. The selling price is \$125,000. \$100,000 is for the assets and \$25,000 is for good will which Mr. Smith will finance. An asset list with values is in the Appendix.

Sales grew 5-20% over the past ten years. Sales were flat last year due to the owner's illness. Our marketing plan, on page 10, shows how we will increase sales. Returns for the last three years are in the Appendix.

- What liabilities are you buying? \_\_\_\_\_
- What is the amount of good will (*difference between the value of hard assets and the business' purchase price*)? \_\_\_\_\_

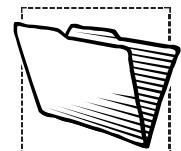
*Note: Sellers might finance part of the business with a loan, especially the good will (include those loan terms here).*

- What documentation have you seen showing the trend of sales? \_\_\_\_\_
- If sales are down, how will you turn them up? \_\_\_\_\_
- What will your management do to make this take-over successful? \_\_\_\_\_
- Will employees leaving the company sign non-compete clauses? \_\_\_\_\_

## CHECKLIST

### Before Signing on the Dotted Line, Make Sure You...

- Review financial statements and tax returns from the last three years.
- Check the quality and the age of accounts receivable.
- Evaluate, price, and determine the age of the inventory.
- Know the age, condition, and cost of any machinery.
- Take pictures of the operation/location.
- Talk to the business' customers and suppliers.
- Get a purchase and sale agreement. *Shows the price's components including the down payment, allocation of the price and how it is financed. The agreement is subject to financing.*



## APPENDIX

Detailed description and appraised values of the building, inventory and equipment. Include the purchase-and-sale agreement, legal documents, a list of the furniture and fixtures, and inspection reports.



# EMPLOYEES

## Hiring Employees

Hiring employees has its own set of rules. Every payday, the business must provide its employees with a statement showing how many dollars were deducted from gross earnings for each legal/tax purpose including federal and provincial tax information, and Unemployment Insurance (UIC). Your accountant can provide federal and provincial tax information. **Note:** *If this is too confusing, payroll service companies will make the calculations, pay the taxes (with your funds), and print paycheques. Look in the phone book.*

- Are employees available? \_\_\_\_\_
- How will you find them? \_\_\_\_\_  
\_\_\_\_\_
- Do you need full-time help? part-time help? \_\_\_\_\_  
\_\_\_\_\_
- Include a schedule of work hours \_\_\_\_\_  
\_\_\_\_\_
- How much are you going to pay each position? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
- What are the employee benefits? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
- How much will the benefits cost you? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
- What are your present and future personnel needs? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
- What training do your employees need and how will you train them?  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_



### APPENDIX

Include benefits and their costs plus training information.

# OPERATIONS & SUPPLIERS

## Operation

- How the product will be manufactured or produced?  
How will your service(s) be rendered?

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- What facilities are required?

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- What equipment is needed? Will it be bought, leased, or rented?

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- How you will handle material processing and inventory control?

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- How does the product get from your company to the buyers/customers?

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## Suppliers

- Who are your suppliers and what will they supply to your business? Is trade credit available? Include a summary of suppliers' detailed quotes in the Appendix. *List names, addresses, goods supplied, terms of sales.*

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- Have you requested financial, managerial, or technical assistance from your suppliers?

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- List the subcontractors, the work they will perform for you, and their terms.

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## APPENDIX

Plans, specifications, suppliers, equipment leases, detailed quotes, contracts subcontractors terms.

# MARKETING PLAN-Part A

*Marketing is the exchange of a product or service for money. A market is a group of people most likely to use your products or services. Before you can reach your markets, you must first identify them.*



**Niche or target marketing** means

*slicing your markets into smaller groups, then selling to them. For example, a nature camp could mail a brochure to subscribers of an outdoor magazine.*



**Research.** Libraries have

*volumes of information about your target market(s). Study consumer and trade magazines, newspapers, books, trade reports, case studies and government statistics, as well as reference books and information on the Internet. Ask the librarian to help you locate websites, books and databases. For example, Standard and Poors and Moodys publish business information by industry.*

**The Ultimate Widget Company**

**Market(s)**

**Geographic Scope:** National

**Size:** 2,000,000 consumers  
Market Percentage we should gain: 35%

**Buyer Profile:**

- Ages: 25-55
- Sex: Male and Female
- Incomes: \$20,000 and up
- Profession: Blue collar and white collar
- Education: High School & University graduates
- Family Size: Single, Couples Families

**Marketing Plan**

**Price**

- Wholesale: \$0.50-\$1.35. Retail: \$1-\$2.70
- Profit: \$0.25-\$0.67 per widget sold
- Competitive Prices:
  - What is a Widget, Inc.: \$0.25-\$1.00 (lower)
  - ABC Widget Company: \$0.75-\$2.00 (higher)
  - Foreign: Cheaper versions. Lower quality.

## Markets/Customers

Who will buy your product or service? For *each* of your target markets, include:

- **Geographic scope:** Where are your customers located?

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- **Size:** Show growth patterns. What percentage of the market do you need to gain? Can you meet demands if the market grows?

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- **Profile** (Describe a typical buyer):

**For consumers:** Age, sex, income, profession, lifestyle, education, family size.

**For businesses:** Type of business, sales, size, number of employees and number of years in business.

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# MARKETING PLAN-Part A (CONTINUED)

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## Price

- How will you price your service or product?

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- Will these prices give you an adequate profit?

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- Are your prices competitive? Show comparisons.

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- Are cheaper products available? List them.

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- Will you offer credit (customers pay at a later date)? How will you handle slow-paying customers?

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- Will you accept credit cards? *Determine 1) the cost of leasing or buying credit card equipment and 2) the commission (percentage) paid to the credit card company.*

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# MARKETING BASICS-Part B

**Product**

- Benefits of your product or service. \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_
  
- How is your product or service different from current products? Explain details in Competition section (page 18). \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_
  
- Is obsolescence possible (*product/service is no longer useful*)? \_\_\_\_\_  
 \_\_\_\_\_
  
- Will you need research and development? How will it be done? What will it cost?  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_
  
- Are there licensing requirements? \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

**Product**  
 Benefits:

- Last 20% longer than competitive products
- Available in three sizes
- Competitively priced

Differentiation:

- Product lasts longer than competitive products
- Widget Comfort Grip™ is more comfortable to hold

Research and Development:

- \$20,000 required to develop widgets in various colors. This should take six months and it will...

Licensing:

- All widgets approved by the Widget Inspectors Lab

**Promotion**

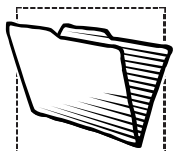
Personal Communications: Met with widget buyers at retail stores. Ten orders promised from buyers.

Mass Communications:

- Advertising: \$125,000. Schedule and breakdown of costs in Appendix (Item 4B).
- Public Relations: \$10,000. Our new product will gain credibility once buyers read publicity articles. Public relations campaign includes press releases sent to...
- Trade Shows: \$40,000 (3 major shows annually)
- Marketing Materials
  - 4-page full color brochure with color photos
  - Packaging: Two color cardboard box

**Distribution**

Products are sold to retailers across the country  
 Vendors: United Parcel Shipping.



**APPENDIX**

Include logos, business materials (letterhead, business cards), brochures, catalogs, advertisements, other marketing materials, advertising budgets and schedules, and industry information.

- Are there industry restrictions and regulations? \_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_
  
- Must you register with any government agencies? \_\_\_\_\_  
 \_\_\_\_\_
  
- Do legal or governmental policies affect your business? \_\_\_\_\_  
 \_\_\_\_\_
  
- Are your products or services protected by any patents, copyrights, or trademarks?  
 \_\_\_\_\_  
 \_\_\_\_\_

# MARKETING PLAN-Part B

## Promotion

- How will you promote your product?

### Personal Communications:

Who will sell your products? How? This includes meetings or phone calls by you, a sales force or reps.

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### Mass Communications:

Includes advertising (*TV, radio, Internet, print and direct mail*), public relations and trade shows. Why did you select these media? Include an advertising schedule in the Appendix (page 36).

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- What promotional marketing materials will you develop (ads, catalogs)? Who will help develop these materials? List costs and promotional materials (ideas or actual samples) in the Appendix (page 36).

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## Distribution

- How will your product or service be made available (retail or wholesale sites, phone and mail orders, over the Internet, and/or telemarketing)?

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- How will you fulfill orders? How much will packaging, materials handling and transportation cost?

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# THE COMPETITION

*Don't underestimate the power of the competition and over-estimate the ability to "steal" customers (or market share) from them. You must determine why someone should buy from your company rather than one of your competitors.*

**Try to list as many of your closest competitors as possible. Compare prices and values.**

- How are their businesses doing? Where are they strong and weak? Why?

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**TAIT'S ALL-NATURAL LAWN COMPANY**

Tait's All-Natural has three competitors in the local area. Two have been in business for over 20 years and are family-owned. Although they have many clients, these two companies do not offer natural products for lawns and bushes.

Tait's offers chemical-free fertilizers, plant growth, and weed-killing products. Our products will not harm animals or children. In fact, customers can walk and play on their lawn immediately after treatments.

The remaining competitor, Reggie & Ruth, is small with only three employees. This company is not able to handle large projects. Tait's All-Natural, with a mixture of 20 full-time and part-time employees, can gain large contracts with homeowners and businesses.

- How is your business better or different from your competitors? Do you offer better quality, service, price or value? Do you have an innovative technology or offer more creativity, flexibility, prestige, or knowledge?

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- How is your business the same as your competitors?

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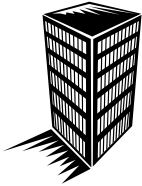
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# BUSINESS LOCATION

- Describe your business' location including the building, physical features, and a floor plan.

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**Location:** Benny's Bagel Shop

Our research indicates that we require 500 square feet of retail space. Highest visibility is on a one-mile stretch between Main Road East and Main Road West. In this area, we have agreed to lease a 550 square foot store in a shopping center with ample parking and high visibility. The lease is for two years with three, one-year renewal options. The rent is \$12 per square foot or \$6,600 per year (\$550 per month). All utilities, taxes, and insurance are included. A copy of the lease is included in the Appendix. There are many other businesses in the area that will draw customers to the business. It is zoned commercial and retail.

- Are any renovations necessary? Get quotes.

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- What are the zoning laws? Does your business comply?

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- What effect does this location have on your costs?

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- Why did you choose this location?

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- Why is it the right building/office for you? Is your building owned by you or leased?

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- You must have a lease if you don't own the property and it must be extendible to match the loan you are requesting. If leased, what are the terms, conditions, length, and cost?

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For retailers:

- Research and show traffic patterns in the Appendix (pg. 36).
- What are the other businesses in the area? Are they good or bad for your business?

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For wholesalers, manufacturers and other businesses:

- Are you close to your customers? \_\_\_\_\_
- Do you have easy access to major highways, railways, and airports?

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## APPENDIX

Include a floor plan, copy of the lease/title, traffic patterns, leasehold improvements (renovation plans), and contractor quotes.

# LOAN REQUEST

## How much will you need?

20-25% of your money must be invested. Show how much (*if any*) you have borrowed from investors, and the amount you are requesting from the lender.

## How long are you asking for repayment?

### • Short Term

(*less than a year*): Short-term loans are called Lines of Credit (LOC) or Revolvers and work like a credit card, with a pre-determined limit. When you need money, you call the bank. Lines of credit are primarily used for working capital purposes.

### • Intermediate Term

(*1-10 years*): Like a car loan, payments are monthly. Use these loans for buying the business, equipment, or for long-term working capital.

### • Long Term

(*10 years or more*): Like a mortgage, these loans are used to buy commercial real estate, commercial boats, and heavy equipment.

## How will the money be used?

Uses include working capital, inventory, equipment or machinery, furniture and fixtures, construction, repairs, expansion, or improvements. Also, for paying off loans or buying a business. Give amounts for each category, and a grand total.

## How will the loan be repaid?

Pay the loan with money from selling an asset, an outside investor, or from business revenue/cash flow.

<b>Amount Needed</b>	
• Amount Requested	\$ _____
• Owner's Investment	\$ _____
• Other Investors	\$ _____
<b>Total</b>	\$ _____
<b>Use of funds</b>	
• Working Capital	\$ _____
• Equipment, Machinery, Computers	\$ _____
• Furniture & Fixtures	\$ _____
• Other	\$ _____
• Real Estate	\$ _____
<b>Total</b>	\$ _____
<b>Repayment</b>	
• Period: _____ years	
• Source: Business Cash Flow	
• Collateral:	
- Accounts Receivable	\$ _____
- Inventory	\$ _____
- Equipment & Machinery	\$ _____
- Furniture & Fixtures	\$ _____
- Office Equipment & Computer	\$ _____
- Equity in Real Estate	\$ _____
- Other	\$ _____
<b>Total</b>	\$ _____

## What collateral do you have to offer?

Collateral consists of assets the bank will take if you can't repay the loan. It can be personal (*savings, stocks, or real estate*), or business (*receivables, inventory, equipment, or real estate*). Be aware that lenders require appraisals, and they discount values. Inventory is discounted 20-30%. Fixed assets are usually discounted 50%. Be sure the total collateral equals the total loan request.



## APPENDIX

Use of funds must be fully documented with quotes. Include a breakdown of equipment, machinery, furniture and fixtures.

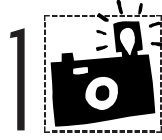
# FINANCIALS

## Accounting Methods: Accrual vs. Cash

There are two ways to handle your accounting - *accrual* or *cash*.

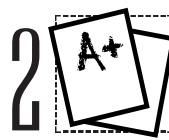
1. The **cash** method means you don't record a sale until you collect money, and you don't record an expense until you pay for it.
2. The **accrual** method, the one lenders want, means:
  - Sales are made but payments are not immediately collected. Your customers pay later, which creates "accounts receivable."
  - Business purchases are made, but paid for later, creating "accounts payable."
  - Assets (like equipment) are depreciated over their lifetime. This is tax deductible.
  - Net Income does not always mean cash since money is tied up in accounts receivable and inventory.

## Four Financial Statements Must Be Included in this Section:



### Balance Sheet

This is a snapshot of your business. A moment frozen in time. See page 22.



### Income Statement

Think of this as your business' "report card." See page 24.



### Personal Financial Statement

Your own personal financial health will be carefully examined by the lender. See page 26.



### Cash Flow Statement

This will show how much money comes in and how much goes out. See page 28.

## Hints for Developing Financials:

- Make realistic assumptions. Don't be afraid to address risks and weaknesses as long as you explain how they will be handled. Lenders know there are risks. They like to see business owners who recognize and solve them. It's a good idea to make a record of your assumptions so you can prove to the lender that your projections are realistic.
- Show reasonable links between the past (*if buying a business*), actual, and future projections.

## Watch for these Common Financial Problems:

- **Limited capital.**  
Capital is just another word for money, and if there's not enough of it, it can lead to insufficient working capital (*money for day-to-day activities*). Don't try to make money stretch too far. Ask for more loan money, or cut down on liabilities and expenses.
- **Little or no record keeping.**  
You must keep meticulous records for yourself, the IRS, and your lender.
- **Failure to seek outside help.**  
Consult an accountant and business advisors. Your advisors' input is valuable but don't be totally dependent on them. Educate yourself. You should have a basic understanding of your company's finances. Know how to read your own financial statements and reports.
- **Poor management.**  
A business needs a good financial manager (*within the company or an outside advisor*). It's your money, so be very self-disciplined.
- **Reluctance to invest in the business.**  
Why should the lender stand behind you if you won't invest any of your own money? You must put 25% to 50% of *your own money* into the company.
- **Failure to personally guarantee the loan repayment.**  
If the business fails for any reason, the owners must repay the loan. Lenders need to be assured of your total commitment.

# BALANCE SHEET

**Date:**

Include last three years fiscal year-end statements and an interim statement (not more than three months old) in the Appendix. Start-up companies: Include an opening Balance Sheet (what the balance sheet will look like the day after the loan closes).

**Depreciation:**

Except for land, assets wear out. The value goes down and can be deducted. Values for assets are presented via a reserve for depreciation. Market value, or the price you could sell it for, will differ from this figure.

**Owners Investment:**

Also called capital or common stock in a corporation

**Retained Earnings:**

Net profits accumulated through the company's life.

**Total Capital:**

Also called net worth

<b>Max Computer Company</b>	
<b>B a l a n c e   S h e e t</b>	
<b>December 31, 2003</b>	
<b>Current Assets</b>	
Cash . . . . .	10,000
Accounts Receivable . . . . .	75,000
Inventory . . . . .	<u>85,000</u>
Total Current Assets . . . . .	170,000
<b>Non-Current Assets</b>	
Fixed Assets . . . . .	140,000
Less Accumulated Depreciation . . . . .	<u>- 25,000</u>
Fixed Assets (net) . . . . .	115,000
Advances to Owners . . . . .	<u>6,000</u>
Total Non-Current Assets . . . . .	<u>121,000</u>
<b>Total Assets (170 + 121)</b> . . . . .	<b><u>291,000</u></b>
<b>Liabilities</b>	
<b>Current Liabilities</b>	
Current Portion of Long-Term Debt . . . . .	6,000
Note Payable . . . . .	100,000
Accrued Taxes . . . . .	3,000
Accounts Payable(A/P) . . . . .	<u>41,000</u>
Total Current Liabilities . . . . .	150,000
<b>Long-Term Liabilities</b>	
Loan Payable . . . . .	<u>54,000</u>
Total L.T. Liabilities . . . . .	<u>54,000</u>
<b>Total Liabilities (150 + 54)</b> . . . . .	<b><u>204,000</u></b>
<b>Capital</b>	
Owners Investment . . . . .	20,000
Retained Earnings . . . . .	<u>67,000</u>
Total Capital . . . . .	87,000
<b>Total Liabilities &amp; Capital (204 + 87)</b> . . . . .	<b><u>291,000</u></b>

**WHAT'S THE BIG IDEA?**



*The Balance Sheet is like a snapshot*

*of your business, frozen for a second. The numbers change every single day.*

**These numbers should be the same.**



*Think of the balance sheet as a seesaw. The assets and liabilities alone are out of balance. Capital, the last weight you put on the scale, makes a perfect balance.*



**YOUR BALANCE SHEET MUST LIST THE FOLLOWING:**

**Assets**

*What the company owns*

**Current Assets**

*Can be converted into cash in one year*

Cash

Accounts Receivable  
*Sales made but not collected*

Inventory  
*Inventory on hand, waiting to be sold*

Total Current Assets  
*Add up all of the current assets*

**Non-Current Assets**

*Takes one year or more to turn into cash*

Fixed Assets  
*This includes property, plant, and equipment*

Less Depreciation  
*Subtract Accumulated Depreciation*

Fixed Assets (net)  
*Fixed Assets minus Accumulated Depreciation*

Advances to Owners

*Money Owners take out of the business in the form of a loan to be repaid*

Total Non-Current Assets  
*Add up all the Non-Current Assets*

**Total Assets**

*Current Assets plus Non-Current Assets*

**Liabilities**

*How much the company owes*

**Current Liabilities**

*Liabilities due within one year*

Current Portion of Long-Term Debt  
*One year's worth of loan payments*

Note Payable  
*Due within one year*

Accounts Payable (A/P)  
*Purchases not paid for*

Total Current Liabilities  
*Total all the Short-Term Liabilities*

**Long-Term Liabilities**

*Due for more than one year*

Loan Payable

*Due after one year's worth of payments*

Total L.T. Liabilities  
*Total all the Long-Term Liabilities*

**Total Liabilities**

*Add the long-term and short-term liabilities*

**Capital or Net Worth**

*The business' equity*

Owners Investment  
*Amount of money owners have invested*

Retained Earnings  
*Income earned and kept in the business*

Total Capital  
*Add Owners Investment and Retained Earnings*

**Total Liabilities & Capital**

*Add Liabilities and Capital. Equal to Total Assets*

# BALANCE SHEET

**Your Company Name**  
**B a l a n c e   S h e e t**  
**date of statement**

**Current Assets**

Cash . . . . .	\$	_____
Accounts Receivable . . . . .	\$	_____
Inventory . . . . .	\$	_____
Other Current Assets . . . . .	\$	_____
<b>Total Current Assets . . . . .</b>	<b>\$</b>	_____

**Non-Current Assets**

Fixed Assets . . . . .	\$	_____
Less Depreciation . . . . .	\$	_____
Assets (net) . . . . .	\$	_____
Advances to Owners . . . . .	\$	_____
Other Non-Current Assets . . . . .	\$	_____
<b>Total Non-Current Assets . . . . .</b>	<b>\$</b>	_____

**Total Assets . . . . .** \$ \_\_\_\_\_

**Liabilities**

**Current Liabilities**

Current Portion of Long-Term Debt . . . . .	\$	_____
Note Payable . . . . .	\$	_____
Accrued Taxes . . . . .	\$	_____
Accounts Payable(A/P) . . . . .	\$	_____
<b>Total Current Liabilities . . . . .</b>	<b>\$</b>	_____

**Long-Term Liabilities**

Loan & Notes Payable . . . . .	\$	_____
<b>Total Long-term Liabilities . . . . .</b>	<b>\$</b>	_____

**Total Liabilities . . . . .** \$ \_\_\_\_\_

**Capital**

Owners Investment . . . . .	\$	_____
Retained Earnings . . . . .	\$	_____
<b>Total Capital . . . . .</b>	<b>\$</b>	_____

**Total Liabilities & Capital . . . . .** \$ \_\_\_\_\_

These numbers are the same.

# INCOME STATEMENT

## WHAT'S THE BIG IDEA?



*The Income Statement is your company's report card. Expenses are subtracted from income, which gives you the business' financial performance or net profit/loss over a period of time. Other names for the Income Statement are Operating Statement, Earnings Statement, or Profit and Loss Statement.*

*In the Appendix, include three years fiscal year end and an interim statement (not more than three months old). Start-up companies: Project month by month for the first year, quarterly for the second year and one whole year for the third year.*

Max Computer Company Income Statement December 31, 2003	
<b>Net Sales</b> .....	900,000
Less Cost of Goods Sold:	
Beginning Inventory .....	75,000
Purchases .....	350,000
Labor .....	<u>200,000</u>
Total .....	625,000
Less: Ending Inventory .....	<u>85,000</u>
Cost of Goods Sold (625 - 85) .....	540,000
<b>Gross Profit (900-540)</b> .....	360,000
Operating Expenses:	
Selling Expenses .....	90,000
General and Administrative .....	<u>170,000</u>
Total Expenses .....	260,000
Operating Income (360 - 260) .....	100,000
Interest Expense .....	<u>20,000</u>
Net Profit before taxes (100 - 20) .....	80,000
Less: All Income Taxes .....	<u>27,000</u>
<b>Net Profit (80-27)</b> .....	<b>53,000</b>

**Date:**  
Represents activity for an entire period, at the end of that time period.

**Net vs. Gross Sales**  
See explanation below

**Operating Income:**  
Gross Profit less Selling Expenses and General/Administrative Expenses.

**Important Note:**  
Compare numbers in the current year's Income Statement with the previous year. You need to know if income/profits and expenses are going up or down (*using percentages*) for control purposes.

## YOUR INCOME STATEMENT MUST LIST THE FOLLOWING:

**Net Sales**  
*Revenue or income. Gross sales is before returns and allowances. Net sales is after returns and allowances.*

Less Cost of Goods Sold  
*Cost to make products including materials and labor*

Beginning Inventory  
*The number used in the sample above was pulled from the Balance Sheet on page 22*

Purchases  
*Used to make product*

Labor  
*Used to make product only. Other labor-related expenses are included in the Operating Expenses section*

Less: Ending Inventory  
*The number used in the sample above was pulled from the previous year's Balance Sheet*

Total Cost of Goods Sold  
*Add up the Cost of Goods Sold*

**Gross Profit**  
*Sales less cost of goods sold. This is your profit margin*

Selling Expenses  
*Salaries and expenses related to sales only*

General and Administrative  
*All other expenses used to run the company*

Operating Income (or Loss)  
*Shows how the business performed*

Interest Expense  
*Subtract interest expense*

Net Profit before taxes  
Less: Income Taxes  
*Tax rates depend on your business' legal status*

**Net Profit**  
*Profit left after all expenses (including taxes) have been paid*

# INCOME STATEMENT

**Your Company Name**

## I n c o m e   S t a t e m e n t

**For the period** \_\_\_\_\_ (year & month) - \_\_\_\_\_ (end year & month)

<b>Sales</b> .....	\$	_____
Less Cost of Goods Sold:		
Beginning Inventory .....	\$	_____
Purchases .....	\$	_____
Labor .....	\$	_____
Total .....	\$	_____
Less: Ending Inventory .....	\$	_____
Cost of Goods Sold .....	\$	_____
<b>Profit</b> (sales-cost of goods sold) .....	\$	_____
Operating Expenses:		
Selling Expenses .....	\$	_____
General and Administrative .....	\$	_____
Total Expenses .....	\$	_____
Operating Income .....	\$	_____
Interest Expense .....	\$	_____
Net Profit before taxes .....	\$	_____
Less: All Income Taxes .....	\$	_____
<b>Net Profit</b> (net profit before taxes-all income taxes) .....	\$	_____

# PERSONAL FINANCIAL STATEMENT

## WHAT'S THE BIG IDEA?



*Personal financial health is*

*carefully examined by the lender or investor. Complete a Personal Financial Statement for each person listed in the business plan who will be guaranteeing the loan (partners, officers, stockholders). It's a good idea to order your credit report from the credit bureau and review it because lenders will scrutinize it. Be prepared to explain any negative reports.*

***Note:** Most lenders will supply you with their own "personal financial statement" form, but the information they usually request is shown in this sample.*



## APPENDIX

*Explain Assets:* copies and statements of life insurance, stocks and bonds, real estate, and personal property. *Explain Liabilities:* notes payable, mortgages on real estate and unpaid taxes. *Loans and mortgages:* Include monthly payment amounts, original balance, current balance and a copy of the last statement.

Personal Financial Statement	
Date _____	Date of Birth: _____
Name _____	If employed, include company name, a person to contact, address, phone number, and number of years in their employment _____
Business Name _____	
Address _____	
_____	
Social Security Number _____	
<b>Assets &amp; Liabilities</b>	
<b>Assets</b> (what you own)	
Cash	\$ _____
Savings Accounts	\$ _____
Retirement Accounts	\$ _____
Accounts & Notes Receivable	\$ _____
Life Insurance, cash surrender value	\$ _____
Stocks & Bonds, market value	\$ _____
Real Estate (fair market value)	\$ _____
Automobiles (fair market value)	\$ _____
Other Property	\$ _____
Other Assets	\$ _____
<b>Total</b>	<b>\$ _____</b>
<b>Liabilities</b> (what you owe)	
Accounts Payable (any business debt you may owe)	\$ _____
Residential Mortgage, balance	\$ _____
Investment Mortgage, balance	\$ _____
Installment Loan Balance, auto	\$ _____
Installment Loan Balance, other	\$ _____
Unpaid taxes	\$ _____
Other liabilities	\$ _____
<b>Total Liabilities</b>	<b>\$ _____</b>
<b>Net Worth</b> (assets less liabilities)	<b>\$ _____</b>
<b>Total Liabilities + Net Worth</b>	<b>\$ _____</b>

# PERSONAL FINANCIAL STATEMENT-PART B

## Income & Expenses

### Annual Income:

- Salary, Bonuses, and Commissions \$ \_\_\_\_\_
- Dividends and Interest (investment income) \$ \_\_\_\_\_
- Real Estate Income \$ \_\_\_\_\_
- Other Income \$ \_\_\_\_\_

### Total

\$ \_\_\_\_\_

Multiply your monthly expenses by 12.

### Annual Expenses:

- Mortgage/Rental payments \$ \_\_\_\_\_
- Loans and notes payable \$ \_\_\_\_\_
- Taxes: Federal, State, Local, Property \$ \_\_\_\_\_
- Insurance premiums \$ \_\_\_\_\_
- Alimony and child support \$ \_\_\_\_\_
- Tuition \$ \_\_\_\_\_
- Medical Exp./Insurance \$ \_\_\_\_\_
- Contingent liabilities \$ \_\_\_\_\_
- Other Debt or Liabilities \$ \_\_\_\_\_

Endorser, co-maker, guarantor of loans or a result of legal actions or contested taxes

### Total

\$ \_\_\_\_\_

This statement is true and accurate. I authorize any inquires necessary to verify its accuracy.

(your signature and date) \_\_\_\_\_

# CASH FLOW STATEMENT

## WHAT'S THE BIG IDEA?



*The Cash Flow Statement is your cash*

*“register.” It shows money that comes into the business and what goes out. Profits do not guarantee positive cash flow. Cash must be available to pay for bills and day-to-day activities. It will also show an important figure, the breakeven point (when cash income equals the cash outflow).*

*This statement must show the company has the cash to pay debts on time.*

*You need to know or estimate income and expenses based on the direct and variable costs of your product or service.*

### Tips for Preparing Cash Flow Statements:

Many of the numbers used in this statement appear in the Income Statement. The Cash Flow Statement differs because it records when cash is received and paid. It is important because it shows how much cash you have reserved.

- Begin with revenue/income at the top, followed by expenses and repayment of the loan (*not vice versa*).
- Round off numbers. Do not use cents.
- Show realistic assumptions. *If sales are projected to increase by 80% every year, the lender may be skeptical.* Prove assumptions and attach to this statement.
- Cover the downside. Identify any weaknesses.
- Cash jumps up from Year 1 to Year 2 because set-up or start-up costs are large in the first year.
- Negative or “Pull down” balances are common in the first year. Deficiencies must be covered by providing more cash (*loans or owners investments*), or reducing expenses.
- Increased sales normally cause a drain on the working capital (*due to increased purchases of raw goods or labor*). Show how you will overcome this.

### Example: Cash Flow Statement

You should project revenue and expenses for three years. Put one year's worth month by month on a page. Fill in the blanks for items (A-H) listed on the next page.

	PRE-START-UP		MONTH 1		MONTH 2		MONTH 3	
	Estimate	Actual	Estimate	Actual	Estimate	Actual	Estimate	Actual
A. Cash on hand								
B. Cash Receipts								
1. Cash Sales								
2. Credit Account								
3. Loans								
C. Total Cash Receipts								
D. Total Cash Available								
E. Cash Paid Out								
1. Purchases								
2. Gross Wages								
3. Payroll Expenses								

## ACROSS THE TOP

*Data for months of the year in the Cash Flow Statement, shown above*

Show monthly figures in the first year, quarterly figures in the second year, and a lump sum or one figure in the third year.

Use the estimated column when constructing this statement.

If the exact amount is known, use the Actual column. Estimates may need to be adjusted in the future as you gain more knowledge and real figures.

## DOWN THE SIDE

Data for items A-H in the Cash Flow Statement

**A. Cash on hand.** After month 1, this figure comes from the Cash Position (Item H) of the previous month.

**B. Cash Receipts.** This is the business' Sales Volume. Include realistic figures based on your facility size, employee output, and realistic sales.

1. Cash Sales. Omit credit sales unless cash is received.
2. Credit Accounts Collections or Accounts Receivable (A/R) is the income expected from all credit accounts.  
*Note: Bad Debt. Should be subtracted from Accounts Receivable in the month anticipated.*
3. Loans. Or other Cash Injection. Specify.

**C. Total Cash Receipts** (B.1 + B.2 + B.3)

**D. Total Cash Available.** Before cash paid out (A + C)

**E. Cash Paid Out**

1. Purchases. Merchandise for re-sale or for use in product (paid in current month).
2. Gross Wages. Base pay plus any overtime. Excludes withdrawals.
3. Payroll Expenses. Include paid vacations, paid sick leave, health insurance, unemployment insurance.
4. Outside Services. Include outside labor and/or material for specialized work.
5. Supplies. Items purchased for business use (office and operating), not for resale.
6. Repairs and Maintenance. Painting, decorating, etc.
7. Advertising. Amount should be adequate to maintain sales volume.
8. Car, Delivery, and Travel. Personal car use including parking fees.
9. Professional Services. Include bookkeeping, accounting and legal.
10. Rent. Real estate only. See E. 16 (below) for other rentals.
11. Telephone.
12. Utilities. Water, heat, electricity.
13. Insurance. Coverage on business property and products.
14. Taxes. Real estate, inventory, sales, and excise taxes.
15. Interest. Add interest on loan as if it was injected. See B.3.
16. Other Expenses. Specify. Unexpected expenditures. Equipment expenses including leases and rentals.
17. Miscellaneous. Small expenditures.
18. Subtotal of operating costs.

**F. Other Operating Costs.**

1. Loan Principal Payment. Payments on all loans including vehicle and equipment purchases.
2. Capital Purchases. Non-expensed (depreciable) expenses such as equipment, building, vehicles, and leasehold agreements.
3. Other Start-Up Costs. Expenses incurred prior to first month projection and paid for after the start-up position.
4. Reserve and/or Escrow. Insurance, tax, or equipment escrow to reduce impact of large periodic payments.
5. Owner's Withdrawal. Include payment for owner's income tax, social security, health insurance.

**G. Total Cash Paid Out** (E plus F).

**H. Cash Position** (End of month) (D minus G). This becomes the "Cash on Hand" (Item A) figure for the next month.

## Essential Operating Data

These non-cash flow items can be kept separately or included at the bottom of your monthly cash flow projections under the heading "Essential Operating Data" (see Section I, on the bottom of page 30). They are important planning and cash flow projection tools.

**1. Accounts receivable** (end of month). Previous unpaid credit sales, plus current month's credit sales, minus amounts received.

**2. Bad Debt** (end of month). Should be deducted from the month anticipated. This figure is based on past history or industry standards.

**3. Inventory on Hand** (end of month). Last month's inventory (any products for sale), plus merchandise received and/or manufactured current month, minus amount sold current month.

**4. Accounts payable** (end of month). Previous month's payable, plus current month's payable, minus amount paid during month. Total cash paid out for expenses.

**5. Depreciation.** Assets wear out and lose value. Established by your accountant, as allowed by Revenue Canada.





# RATIOS

## WHAT'S THE BIG IDEA?

**Ratios** are your business' scores. Lenders will compare your ratios to others in your industry in order to make decisions about your business and loan request.

### 1 ASSET MANAGEMENT RATIOS

#### Accounts Receivable Turnover

Number Source: Balance Sheet (pg.22) & Income Statement (pg.24)

#### F O R M U L A

$$\frac{\text{Accounts Receivable } (\$75,000 \text{-- pg. 22}) \times 365 \text{ days}}{\text{Net Sales Figure (pg. 24)}} = 30.4$$

It takes 30 days to collect bills

**NOTE:** This shows how many days it takes to collect money owed to you. Lower answers are better.

#### Inventory Turnover

Number Source: Balance Sheet (pg.22) & Income Statement (pg.24)

#### F O R M U L A

$$\frac{\text{Inventory Figure } (\$85,000 \text{-- pg. 22}) \times 365 \text{ days}}{\text{Cost of Goods Sold (pg. 24)}} = 57.4$$

57 days to turnover or sell the inventory

**NOTE:** This formula shows how many days it takes you to turnover (or sell) your inventory. Lower answers are better.



### LIQUIDITY RATIOS

How "cash rich" is a company? Liquidity ratios show a company's ability to turn an asset into cash.

#### Working Capital

Number Source: Balance Sheet (pg.22)

#### F O R M U L A

$$\frac{\text{Current Assets (pg. 22)} - \text{Current Liabilities (pg. 22)}}{\text{Working Capital}} = \$20,000$$

Working Capital

**NOTE:** Shows if a company has enough cash to pay bills. This example shows an excess amount after paying all current liabilities. The answer must be positive. More money is needed to meet expenses if the answer is a negative number.

#### Quick or Acid Test Ratio

Number Source: Balance Sheet (pg.22)

#### F O R M U L A

$$\frac{\text{Total Current Assets of } \$170,000 \text{ (pg. 22) less Inventory of } \$85,000 \text{ (pg. 22)}}{\text{Total Current Liabilities (pg. 22)}} = .56$$

The answer should be 1 or more. In this example, the answer, \$0.56, is less than 1. The company could not pay all its current liabilities without selling some inventory.

**NOTE:** Inventory may become no longer useful. This ratio eliminates inventory from current assets and cash. It's called "quick" because it includes items that can be turned into cash.

#### Current Ratio

Number Source: Balance Sheet (pg.22)

#### F O R M U L A

$$\frac{\text{Total Current Assets (pg. 22)}}{\text{Total Current Liabilities (pg. 22)}} = 1.13$$

Times you can pay current liabilities

**NOTE:** Tests a company's short-term debt paying ability. This means there is \$1.13 in cash and current assets available to pay every \$1 of current liabilities.

# RATIOS

3

## DEBT MANAGEMENT RATIOS

### Leverage (or Debt to Worth) Ratio

Number Source: Balance Sheet (pg.22)

#### F O R M U L A

$$\frac{\text{Total Liabilities (pg. 22)} \quad \$204,000}{\text{Total Capital (pg. 22)} \quad \$87,000} = 2.34$$

The company is leveraged 2.34 times



**NOTE:** Determines if a company has enough equity. Lower answers are better. Lenders prefer this ratio to be 3 or lower.

### Accounts Payable Turnover

Number Source: Balance Sheet (pg.22) & Income Statement (pg. 24)

#### F O R M U L A

$$\frac{\text{Accounts Payable at } \$41,000 \text{ (pg. 22)} \times 365 \text{ days}}{\text{Purchases (pg. 24)} \quad \$14,965,000} = 42.75$$

Accounts Payable are paid every 43 days

**NOTE:** Shows how quickly a company pays its suppliers. Lower numbers are better.

4

## PROFITABILITY RATIOS

### Profit Margin on Sales

Number Source: Income Statement (pg.24)

#### F O R M U L A

$$\frac{\text{Net Profit (pg. 24)} \quad \$53,000}{\text{Net Sales (pg. 24)} \quad \$900,000} = .0588$$

The profit margin is 5.9%

**NOTE:** Shows the percentage of net profit for every dollar of sales. If the profit margin is too low:

1. the prices are too low
2. the cost of goods is too high
3. expenses are too high

### Cash Flow to Current Maturities (Debt Service) Ratio

Number Source: Balance Sheet (pg.22) & Income Statement (pg.24)

#### F O R M U L A

$$\frac{\text{Net Profit of } \$53,000 \text{ (pg. 24) + Depreciation of } \$10,000 \text{ (amount created for this example)} \quad \$63,000}{\text{Current Portion of Long Term Debt (pg. 22). For new businesses, use one year's worth of loan payments.} \quad \$6,000} = 10.5$$

For every dollar of payments, \$10.50 is available to pay it

**NOTE:** Shows your ability to pay term debts after owner(s) withdrawals. Lenders prefer 2 or better.



## BREAK EVEN POINT

### It is important to determine your Breakeven Point

Number Source: Income Statement (pg. 24)

When a company has neither a profit nor a loss (when the answer is zero), it is the breakeven point. One dollar more and the company has a profit; one dollar less and the company shows a loss.

#### F O R M U L A

$$\begin{array}{r} \$900,000 \\ - \$630,000 \\ - \$170,000 \\ \hline \$100,000 \end{array}$$

**Revenue** (pg. 24).  
**Variable Expenses** Cost of goods sold and selling expenses (540,000 + 90,000).  
**Fixed Expenses** General and Administrative expenses (pg. 24).

**Breakeven Point**  
 This company is profitable

## 1-2-3 RULE

Pre-qualify your business for financing (amount shown in the Loan Request, pg. 20)

- 1 One times discounted collateral coverage of the loan. For example, \$100,000 loan x 1=\$100,000 collateral required)
- 2 Two times the annual loan payment principal plus interest in annualized cash flow (cash flow is net profit plus depreciation less taxes). See Section 4- Profitability Ratios-Profit Margin Ratio
- 3 Three times equity or net worth to calculate the maximum loan. See Ratios Section 3-Debt Management Ratios- Leverage Ratio

# RATIOS FILL IN

## 1 ASSET MANAGEMENT RATIOS

### Accounts Receivable Turnover

Accounts Receivable (Balance Sheet) X 365 days

Net Sales Figure (Income Statement)

shows how many days it takes to collect money owed to you. Lower answers are better.

$$\frac{\$ \text{_____}}{\$ \text{_____}} = \text{_____}$$

### Inventory Turnover

Inventory Figure (Balance Sheet) X 365 days

Cost of Goods Sold (Income Statement)

Number of days to turnover or sell the inventory. Lower answers are better.

$$\frac{\$ \text{_____}}{\$ \text{_____}} = \text{_____}$$

## 2 LIQUIDITY RATIOS

### Working Capital

Current Assets (Balance Sheet)

Subtract Current Liabilities (Balance Sheet)

Shows if a company has enough cash to pay bills. Answer must be positive.

$$\$ \text{_____} - \$ \text{_____} = \$ \text{_____}$$

### Quick or Acid Test Ratio

Total Current Assets less Inventory (Balance Sheet)

Total Current Liabilities (Balance Sheet)

Eliminates inventory from current assets and cash. "Quick" means items can be turned into cash.

$$\frac{\$ \text{_____}}{\$ \text{_____}} = \text{_____}$$

### Current Ratio

Total Current Assets (Balance Sheet)

Total Current Liabilities (Balance Sheet)

Your company's short-term debt paying ability. Answer should be 2 or more.

$$\frac{\$ \text{_____}}{\$ \text{_____}} = \text{_____}$$

## 3 DEBT MANAGEMENT RATIOS

### Leverage (or Debt to Worth) Ratio

Total Liabilities (Balance Sheet)

Total Capital (Balance Sheet)

The company is leveraged \_\_\_\_\_ times. Ratio to be 3 or lower.

$$\frac{\$ \text{_____}}{\$ \text{_____}} = \text{_____}$$

### Accounts Payable Turnover

Accounts Payable (Balance Sheet) X 365 days

Purchases (Income Statement)

How quickly a company pays its suppliers. Accounts Payable are paid every \_\_\_\_\_ days.

$$\frac{\$ \text{_____}}{\$ \text{_____}} = \text{_____}$$

## 4 PROFITABILITY RATIOS

### Profit Margin on Sales

Net Profit (Income Statement)

Net Sales (Income Statement)

The profit margin is \_\_\_\_\_% (move decimal point over two spaces)

$$\frac{\$ \text{_____}}{\$ \text{_____}} = \text{_____}$$

### Cash Flow to Current Maturities (Debt Service) Ratio

Net Profit + Depreciation (Income Statement)

Current Portion of Long Term Debt. For new businesses, use one year's worth of loan payments (Balance Sheet)

For every dollar of payments, \$\_\_\_\_\_ is available to pay it. Lenders prefer 2 or better.

$$\frac{\$ \text{_____}}{\$ \text{_____}} = \text{_____}$$

## BREAK EVEN POINT

**F O R M U L A**

Revenue

- Variable Expenses  
*Cost of goods sold and selling expenses.*

- Fixed Expenses  
*General and Administrative expenses.*

0

**Breakeven Point**

$$\begin{matrix} \$ \text{_____} \\ - \$ \text{_____} \\ - \$ \text{_____} \\ \hline 0 \end{matrix}$$

# RATIOS

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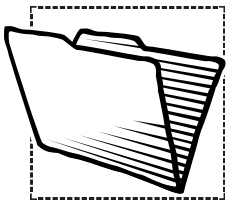
## Points to Remember about Ratios:

- There are hundreds of ratios. This book includes the most common ones, grouped into four categories. Ratios are not included in your business plan, but you should calculate them in order to see which areas of your business differ from industry standards.
- Ratios come from the Income Statement and Balance Sheet, not the Cash Flow Statement.
- A ratio of 38% compared to an industry average of 39% seems like a small 1% difference. If sales are \$4 million, 1% is \$40,000. If net profits are \$100,000, then the \$40,000 is very important.
- Compare your ratios to industry averages. Lenders and investors compare your ratios to their acceptable ranges, or to a (existing) company's prior years, or to business history to see trends.
- Industry ratios are averages. Some firms are above and some firms are below these numbers. Differences are due to the age of the company, locations, managers, and operations, to name a few.
- Industry standards can be found in reference books at a library. Companies are grouped by "S.I.C." code (Standard Industrial Classification). Study the data carefully and decide which ratio resources are the best for your business. References include:
  - Dun & Bradstreet
  - Trade Associations
  - Trade periodicals

*Magazines and newspapers specifically written for your industry*

# APPENDIX ITEMS CHECKLIST

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## **Include the following items in the back of your business plan:**

### **Business Description-page 8**

- Owners and managers resumes
- Management contracts
- Detailed industry information

- Seasonal business information (if applicable)

### **Buying a Business-page 10**

- Inventory evaluation
- Accounts receivable aging and evaluation
- Business Debt
- If available, appraisals and purchase prices of real estate, equipment, vehicles, and machinery.
- Franchise agreements
- Buy/Sell or Purchase/Sale agreements

### **Management and Employees-pages 11 & 12**

- Detailed operations information including costs for employee benefits and training

### **Operations & Suppliers-pages 13**

- Cost estimates for purchase of machinery, equipment, furniture and fixtures
- Suppliers and detailed quotes
- Subcontractors and their terms

### **Marketing Plan-pages 14-17**

- Logos, stationery, brochures, catalogs, business cards, and other marketing pieces
- Advertising examples, schedules, and budgets
- Patents and trademarks, if applicable
- News articles pertinent to the business

### **Competition-page 18**

- Detailed competitive information and analysis

### **Location-page 19**

- Lease and options
- List of leasehold improvements (remodeling) and cost estimates
- Contracts for services to be rendered
- Pictures of property, inside and out showing operations  
Blueprints and floor plan and plot plan (if building)
- Zoning statement from local government

- Maintenance agreements
- Traffic patterns
- Approval letters from local and state inspectors (Building, Fire, Health, Environmental and Occupational Safety)
- Environmental impact study (if applicable)
- Deed to land and legal description (if building or buying)

### **Loan Request-page 20**

- Detailed collateral/assets information
- Detailed use of funds

### **Financial Information-pages 21-31**

#### **Include and explain assumptions made when projecting income and expenses**

- Balance Sheet:** For existing businesses, include the last three years. For new businesses, an Opening Balance Sheet
- Income Statement:** For existing businesses, include the last three years. Start-up companies: projections for first year by month, second year by quarter, and third year as one year
- Personal Financial Statement:**
  - Stocks and Bonds.** List each stock and bond, number of shares, and the cost.
  - Contingent liabilities.** Explain any.
  - Assets.** Itemize each one.
  - Mortgages and loans** Lenders need to review monthly payments, original balance, current balance, terms and fair market value. Include noteholder's name and address, title holder, date acquired, and account number.

**Note :** Attach personal financial information from individuals who own more than 20% of the business including three years worth of personal tax returns.

- Cash Flow:** Analysis for three years. Monthly for first year, quarterly for second year, lump sum for third year.