ENTR 3 & 4 Review

3-1 Choose a Form of Business

Explore the advantages and disadvantages of purchasing an existing business, starting a franchise, joining a family business, or starting a new business; Explore the advantages and disadvantages of establishing your business as a sole proprietorship, partnership, or corporation.

DECIDE TO PURCHASE, JOIN, OR START A BUSINESS

- Purchase An Existing Business
- Franchise Ownership
- Enter A Family Business
- Starting Your Own Business

CHOOSE A LEGAL FORM OF BUSINESS

Sole Proprietorship

Once you decide to start your own business, you must decide what type of ownership the business will have. A business that is owned exclusively by one person is a sole proprietorship. Sole proprietorships enable one person to be in control of all business aspects. Sole proprietorships may be very small businesses with just a few employees, or they may be large businesses with hundreds of employees.

- Advantages: The government exercises very little control over sole proprietorships; Accurate tax records and certain employment laws must be met; Sole proprietorship is the most common form of ownership in the US; You get to make all of the business decisions and keep all of the profits the business earns.
- Disadvantages: It can be difficult to raise money for a sole proprietorship. You often are the only person investing money in the business. You also bear the burden of all of the risks. If a sole proprietorship fails and debts remain, the entrepreneur's personal assets may be taken to pay what is owed.

Partnership

A business owned by two or more people is a partnership. Many entrepreneurs prefer to go into business with one or more partners so that they have someone with whom to share decision-making and management responsibilities as well as the risks involved with entrepreneurship.

- Advantages: Running a business as a partnership means that you will not have to come up with all of the capital alone. It also means that any losses the business incurs will be shared by all of the partners. Partners may offer different areas of expertise and knowledge, which can strengthen the business. Like sole proprietorships, partnerships face very little government regulation.
- Disadvantages: Some entrepreneurs do not like partnerships because they do not want to share responsibilities and profits with other people. They fear being held legally liable for the errors of their partners. Partnerships can also lead to disagreements and can end bitterly.

Corporation

A corporation is a business that has the legal rights of a person but is independent of its owners. A share of stock is a unit of ownership in a corporation. There may be many owners, who are called shareholders or stockholders. The corporation, not the owners, pays taxes, enters into contracts, and may be held liable for negligence.

- Advantages: The shareholders' liability is limited to the amount of money each shareholder invested in the company when he or she purchased stock. The personal assets of shareholders may not be taken to pay the debts of the corporation. Another advantage of corporations is that money can be raised by selling stock.
- Disadvantages: Setting up a corporation is more complicated than setting up a sole proprietorship or a partnership. To incorporate, you will need the assistance of a lawyer; Establishing a corporation can be costly; Corporations are subject to much more government regulation than are sole proprietorships or partnerships; Income is taxed twice.

3-2 Legal Issues and Business Ownership

Recognize how laws promote competition; Describe how entrepreneurs protect intellectual property; Identify regulations that protect the public and how they affect businesses; Describe when and how a business owner should seek legal advice.

- Antitrust Legislation; Government Agencies That Protect Competition
- Intellectual Property (Patents, Copyrights, Trademarks)
- Laws That Protect Consumers (Licenses, Zoning Laws, Consumer Protection Laws)
- Legal Issues Affecting Business (Contracts, Torts, Agency Relationships)

Patents: A patent is the grant of a property right to an inventor to exclude others from making, using, or selling his or her invention.

Copyrights: A copyright is a form of intellectual property law that protects original works of authorship, including literary, dramatic, musical, and artistic works. Copyrights remain in effect for 70 years after the death of the author. A copyright allows the author to license the use of the material for a royalty payment.

Trademarks: A trademark is a name, symbol, or special mark used to identify a business or brand of product. Products that are trademarked are identified by the ™ or ® symbol.

3-3 Choose a Location and Design the Layout

Identify options for locating both a retail business and a nonretail business; Identify the benefits of locating a business online; Describe the steps to take in selecting a site; Compare purchase and lease options; Describe layout considerations for different types of businesses.

Choosing A Location

- Your location plan will help ensure that your product is available in the right location to reach your target customer. There are different considerations for locating retail businesses and nonretail businesses.
- Locating A Retail Business: Downtown Areas, Neighborhood/Community/Regional Shopping Centers, Stand-Alone Stores, Warehouses.

- Locating A Nonretail Business: Service Businesses, Industrial Businesses, Home-Based Businesses.
- Online Businesses.

Selecting Your Site

- Location, Type, and Availability
- Evaluate the Location
- Lease Or Buy Space

Design The Layout Of Your Business

- Create the Floor Plan
- Layout of a Retail Business, Service Business, Wholesale Business, Manufacturing Business

3-4 Purchase Equipment, Supplies, and Inventory

Explain how to find and choose vendors for your business; List factors that determine the needed level of inventory.

Obtain Equipment and Supplies

Every business needs to analyze its operational needs and select equipment, supplies, and goods and services based on these needs.

- Equipment includes things such as machinery, computers, cash registers, and furniture.
- Supplies include things like paper, pens, and pencils.

Purchase Inventory

- Inventory consists of the products and the materials needed to make the products that a business sells to its customers.
- Retailing, wholesaling, and manufacturing businesses must purchase inventory before they can open for business. For retail and wholesale businesses, inventory is merchandise (a finished product) purchased with the intent of reselling it to customers. For manufacturing businesses, inventory consists of the business's finished product as well as the parts that go into producing the finished product.
- Determining the amount of inventory to keep in stock is difficult for all business owners. It is particularly difficult for owners of new businesses, who do not yet know what their level of sales will be.

3-5 Identify Your Staffing Needs

Explain how to determine staffing needs for a business; Describe options for recruiting employees and alternatives to hiring permanent employees; List and describe the steps in the hiring process; Describe compensation packages for employees; Identify laws protecting employee rights.

Staffing

- Staffing involves determining the number of employees you need and defining a process for hiring them.
- The management functions of staffing, implementing, and controlling can be directly applied to the people who work for your business. The people who work for your business are your human resources. You may not need to hire employees when you first start your business. But as your business grows, you will find the need for employees.

Job Descriptions

- A job is a collection of tasks and duties that an employee is responsible for completing.
- A task is a specific work activity that is performed, such as answering the telephone or answering e-mail.
- A job description is a written statement listing the tasks and responsibilities of a position.

Organizational Structure

- Once your company has several employees, you will need an organizational structure. An organizational structure is a plan that shows how the various jobs in a company relate to one another. Many businesses use a chart to represent the organizational structure.

Recruiting

- To recruit is to look for people to hire and attract them to the business. As the owner of a small business, it may be difficult for you to attract experienced employees to work for your business.

The Hiring Process

- Screen Candidates; Review and Verify Information on Job Applications; Interview the Best Candidates; Make a Job Offer; Compensation Package (Wages, Salaries, Benefits)

3-6 Business Risks

List and explain steps involved in preparing to face risks; Discuss types of theft and security precautions to take to protect your business.

Dealing With Business Risks

- As an independent businessperson, you will face many risks. Risk is the possibility of some kind of loss. Risk management is taking action to prevent or reduce the possibility of loss to your business. You can avoid/reduce, assume, or transfer risk.

Identifying Risks

- Human Risks. Human risks are those caused by the actions of individuals, such as employees or customers.
- Natural Risks. Natural risks are caused by acts of nature.
- Economic Risks. Economic risks occur because of changes in business conditions.

Preparing To Face Risks

- Avoid/Reduce the Risk
- Assume the Risk
- Transfer the Risk

Determine What Can Go Wrong

As a business owner, the first thing you need to do is conduct a risk assessment. A risk assessment involves looking at all aspects of your business and determining the risks you face. During this assessment, you should:

- Learn the risks your business faces.
- Decide how the risks would affect your business.
- Prioritize the risks by the impact they will have on your business.

Types Of Theft

One of the biggest risks that businesses face is theft. Shoplifters and employees may steal your merchandise. Burglars may break into your business and steal your equipment. Customers may use stolen credit cards or write checks when they don't have money in their account. Once you have identified the theft risks you face, you can determine what security precautions you need to take.

3-7 Insure Against Risks

Identify risks faced by business owners and explain why some business risks are uninsurable; Determine the different types of insurance you need for your business; Explain how to manage credit risks.

Result of the Risk

- A pure risk presents the chance of loss but no opportunity for gain.
- A speculative risk offers you the chance to gain as well as lose from the event or activity.

Controllability of the Risk

- A controllable risk is one that can be reduced or possibly even avoided by actions you take. Installing a security system in your business could lessen the risk of your business being robbed.
- An uncontrollable risk is one on which actions have no effect. The weather cannot be controlled, but it can have a tremendous effect on some businesses.

Insurability of the Risk

- A risk is an insurable risk if it is a pure risk faced by a large number of people and the amount of the loss can be predicted.
- If there is a risk that a loss will occur and the amount of the loss cannot be predicted, the risk is uninsurable.

Types Of Insurance

- Business Insurance
- Life Insurance
- Other Kinds of Insurance
- Determine How Much Coverage You Need
- Workers' Compensation

3-8 Financing Your Business

Estimate your startup costs and personal net worth; Identify sources of equity capital for your business; Identify sources of debt capital for your business.

Startup Costs

Itemizing your startup costs is an important part of determining how much money you need to start your business. You will want to be sure you have accounted for all of the items you will need. Common startup items to be purchased include the following:

- Equipment and supplies, such as computers, printers, telephones, and paper
- Furniture and fixtures, such as desks and chairs
- Vehicles, such as delivery trucks
- Remodeling, such as electrical/plumbing expenses

Financing Your Business

There are two types of financing available for your business-equity and debt financing. When obtaining financing, you must consider your company's debt-to-equity ratio, or the relation between the dollars you have borrowed (debt) and the dollars you have invested in your business (equity). This ratio measures how much money a company can safely borrow over time.

Equity Capital

Equity capital is money invested in a business in return for a share in the profits of the business. Equity capital includes money invested by the owner. Entrepreneurs may seek additional equity capital when they do not quality for other types of financing and are not able to fully finance their business out of their own savings.

- Personal Contributions
- Friends and Relatives
- Venture Capitalists

Debt Capital

Debt capital is money loaned to a business with the understanding that the money will be repaid, usually with interest. You can borrow money from friends, relatives, and banks. Bank loans may be secured or unsecured.

- Friends and Relatives
- Commercial Bank loans
- Other Sources of Loans (SBA, SBICs, MESBICs, etc.)

4-1 Sales Forecasting

Understand the steps involved in preparing a sales forecast.

4-2 Cost of Doing Business

Understand the importance of good recordkeeping; Define fixed expenses; Explain how variable expenses are calculated; Define economies of scale.

Business Documents

- Receipts, Purchase Orders, Sales Invoices

The Cost Of Doing Business

- Fixed Expenses (Insurance, Salaries, Advertising, Interest, Depreciation, Utilities, Rent, etc.)
- Variable Expenses (Cost of Goods Sold … or Cost of Services Sold)
- Economies of Scale

4-3 Economics of One Unit of Sale (EOU)

Define a unit of sale and explain how to calculate the economics of one unit of sale; Explain the importance of the break-even point and calculate a break-even analysis.

Contribution Margin (also known as Gross Profit per Unit)

- Selling Price - Variable Expenses = Contribution Margin

Break-Even Analysis

- Operating Expenses ÷ Gross Profit per Unit = Break Even Units

4-4 Income Statement

Explain the importance of an income statement; Understand the parts of an income statement.

Income Statement

- An income statement is a financial document that summarizes a business's income and expenses over a given time period and shows whether the business made a profit or took a loss.
- Entrepreneurs should create income statements on a monthly, quarterly, and annual basis.

Revenue
Cost Of Goods Sold
Gross Profit
Operating Expenses
Pre-Tax Profit
Taxes
Net Profit

4-5 Cash Flow Statement

Understand how cash flow affects entrepreneurs; Demonstrate a burn-rate calculation.

Cash Flow Statement

- To monitor cash flow, a business prepares a cash flow statement. This is a financial document that records inflows and outflows of cash when they actually occur.

Cash Inflow - Cash Outflow = Net Cash

Ways to Keep Cash Flowing

- Collect Cash as Soon as Possible
- Pay Bills Close to the Due Date
- Keep Track of Your Cash
- Lease Equipment
- Keep Inventory to a Minimum

The Burn Rate

- The rate at which a company spends cash to cover overhead costs without generating a positive cash flow is called the burn rate. It is typically expressed in terms of cash spent per month.
- Cash on Hand ÷ Burn Rate = Number of Months before Cash Runs Out

4-6 The Balance Sheet

Identify the purpose and components of a balance sheet; Explain how balance sheets are prepared; Provide two methods used to analyze balance sheets.

Balance Sheet

- A balance sheet is a financial statement that summarizes the assets and liabilities (debts) of a business. It shows how much a business is worth at a particular time.
- A balance sheet is like a snapshot of a business on a specific date.

Assets = Liabilities + Owner's Equity

- Assets. Everything owned by the business that has a monetary value is an asset. This could include such things as cash, inventory, equipment, and supplies.
- Liabilities. Any outstanding bill or loan that must be repaid is a liability.
- Owner's Equity. The value of the business on a specific date is referred to as the owner's equity. It's the value of the business if all the assets were sold and all the liabilities were paid.

Assets Are Owned

- Current Assets. Short-term assets that can be converted into cash within one year are current assets. These include cash, inventory, marketable securities, and money owed the business by its customers (called accounts receivable). Accounts receivable is the amount of money owed to a business by its customers for credit sales.
- Long-Term Assets. Assets that usually take longer than one year to turn into cash are long-term assets. Examples of long-term assets are equipment, computers, furniture, machinery, buildings, and long-term investments.

Liabilities Are Owed

- Current Liabilities. Short-term debts that must be repaid within one year are current liabilities. These include debts to suppliers for credit purchases (accounts payable), bank loans, and state sales taxes collected from customers and owed to the state.
- Long-Term Liabilities. Debts that usually take longer than one year to repay are long-term liabilities. The money owed on a mortgage, for example, is a long-term liability.

4-7 Financial Ratios

Recognize financial ratios used to analyze the financial condition of a business; Discuss how ratios aid in financial decision making.

Ratio Analysis

- How do entrepreneurs know if a company is healthy? They often rely on information from financial records. But it's not always easy to analyze these records, to see the relationships, patterns, and the trends they show.
- One of the most effective ways for entrepreneurs to analyze their financial statements is to use financial ratios.

Liquidity Ratios

- Current Ratio = Current Assets / Current Liabilities
- Quick Ratio = (Current Assets – Inventory) / Current Liabilities
- Cash Ratio = (Cash + Investments) / Current Liabilities

Asset Management Ratios

- Inventory Turnover = Revenues / Inventory
- Total Assets Turnover = Revenues / Total Assets
- Accounts Receivable Turnover = Revenues / Accounts Receivable

Debt Management Ratios

- Debt Ratio = Total Debt / Total Assets
- Times Interest Earned = Operating Income / Interest Expense

Profitability Ratios

- Profit Margin = Net Income / Revenues
- Return on Assets (ROA) = Net Income / Total Assets
- Return on Equity (ROE) = Net Income / Stockholders' Equity

Market Performance Ratios

- Earnings Per Share (EPS) = Net Income / Number of Shares
- Price Earnings Ratio (P/E) = Market Stock Price / EPS
- Market to Book Ratio = Market Stock Price / Book Value Per Share

One of the uses of financial ratios is to compare specific aspects of a company's financial performance with other companies (known as benchmark companies). Since most public corporations are required to publish financial statements at least annually, it is relatively easy to obtain comparative financial information.