3-1 Legal Issues and Business Ownership

OBJECTIVES

- ***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.***

REGULATIONS THAT PROMOTE COMPETITION

As an entrepreneur, you will learn that there are laws affecting almost every aspect of your business. Even the competition that businesses face is regulated by the government. To make sure that competition is fair, federal, state, and local governments have enacted various laws to help protect businesses.

ANTITRUST LEGISLATION

Beginning in 1890, laws were created that made monopolies in certain industries illegal. A monopoly is also called a trust, so these laws were called antitrust laws. Antitrust laws also ban other types of business activities that do not promote competition. It is important to become familiar with these laws to determine how they affect your business.

- **Sherman Act**. This law makes it illegal for competitors to get together and set prices on the products or services they sell. This means that you and your competitors cannot jointly decide to keep prices at a certain level. Discussing prices with competitors is illegal. For example, if the owner of one business decides to raise his prices, he cannot ask the owner of a competing business to raise her prices by the same amount.
- **Clayton Act**. This law states that it is illegal for a business to require a customer to buy exclusively from it or to purchase one good in order to be able to purchase another good. A distributor of computers, for example, cannot force customers to purchase software when they purchase a computer. Customers must be free to buy only the products or services they want from whom they want.
- **Robinson-Patman Act**. This law protects small businesses from unfair pricing practices. It makes it illegal to discriminate by charging different prices to customers. A manufacturer, for example, may not sell its products at different prices to similar customers in similar situations when the effect of such sales will reduce competition. Differences in price may only be justified based on differences in quantities purchased (volume discounts), special distribution or legal requirements in different locations, or other economically sound reasons. If your business sells to other businesses, you must offer the same terms to all of those businesses. The law does not apply to retail stores where certain groups may be targeted by special promotions, such as giving discounts to senior citizens.
- **Wheeler-Lea Act**. This law bans unfair or deceptive actions or practices by businesses that may cause an unfair competitive advantage. False advertising is an example. Under this act, businesses are also required to warn consumers about possible negative features of their products. Drug companies, for example, must let people know of any side effects they may experience from using a medication.

GOVERNMENT AGENCIES THAT PROTECT COMPETITION

The Antitrust Division of the Justice Department and the Federal Trade Commission are two government agencies that work to make sure competition among businesses remains fair. Other agencies, such as the Federal Aviation Administration and the Food and Drug Administration, oversee business practices in particular industries.

- **Justice Department**. The Justice Department's Antitrust Division takes legal action against any business it believes has tried to monopolize an industry. It also prosecutes businesses that violate antitrust laws, which can lead to fines or jail.
- **Federal Trade Commission**. The Federal Trade Commission (FTC) deals with issues that touch the economic life of every American. The FTC administers most of the laws dealing with fair competition and pursues vigorous and effective law enforcement. Some of the activities the FTC monitors include false or misleading advertising, price setting by competitors, price discrimination, and misrepresentation of the quality, composition, or place of origin of a product. It is the only federal agency with both consumer protection and competition jurisdiction in broad sectors of the economy.

INTELLECTUAL PROPERTY

Intellectual property is the original, creative work of an artist or inventor and may include such things as songs, novels, artistic designs, and inventions. Such works may be registered for special government protections- including patents, trademarks, trade names, and copyrights-that provide business owners with the exclusive use of the intellectual property in the United States and many foreign countries. Registration gives businesses or individuals the exclusive right to profit from what they have created. No one else can use their creations to make money. If you violate another person's patent, copyright, or trademark, you could be sued.

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. The intent of a patent is to give the developer of a new product time to recover the development costs without having to worry about competition. Patents are issued by the U.S. Patent and Trademark Office and last for 20 years. During this period, no business or individual can copy or use the patented invention without the patent holder's permission. A provisional patent application allows an inventor one year to investigate the feasibility, marketability, and potential license interest of an invention before deciding to file a formal patent application. This allows the inventor to use the term patent pending, giving him or her a head start on other inventors who may file for the same invention.

COPYRIGHTS

A copyright is a form of intellectual property law that protects original works of authorship, including literary, dramatic, musical, and artistic works. Copyright law does not protect facts, ideas, systems, or methods of operation. All books must have a copyright. A copyright lists the publisher of the work and the year in which the work was published. 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. Examples include Band-Aid® and Kleenex®. You could not invent a new bandage and use the term Band-Aid in the product name. Nor could you use the "swoosh" mark that is trademarked by Nike in any product or business promotion you conduct.

LAWS THAT PROTECT CONSUMERS

The government also has regulations that protect consumers. They include licenses, zoning regulations, and consumer protection laws.

LICENSES

State and local governments require some businesses to have licenses. Beauty salons, restaurants, and health and fitness centers are just some of the companies that must carry licenses. If you own a business that requires a license, you and your employees may need to complete training requirements. You may also need to have regular inspections by state and local authorities. Failure to meet certain standards could mean the loss of your license and the closing of your business.

ZONING LAWS

Local governments often establish zoning regulations that control what types of buildings can be built in specific areas. In many communities, certain areas are zoned for residential use only. This means that business buildings may not be built in those areas. Other areas may be zoned as commercial for retail businesses, as industrial, as agricultural, as multipurpose, and so on. All businesses must obey zoning regulations. Before you choose a location for your business, you will have to make sure that the area you have selected allows your type of business to operate there. Zoning laws help keep neighborhoods safe for its residents.

CONSUMER PROTECTION LAWS

A variety of laws and government agencies protect the public from harmful products. You will have to make sure that the products you manufacture or sell meet all consumer protection standards.

- **The Federal Food, Drug, and Cosmetic Act**. This law bans the sale of impure, improperly labeled, falsely guaranteed, and unhealthful foods, drugs, and cosmetics. The Food and Drug Administration (FDA) enforces this law. The FDA has the power to force producers to stop manufacturing products that are unsafe.
- **The Consumer Product Safety Act**. This law sets safety standards for products other than food and drugs. When the Consumer Product Safety Commission determines that a product is unsafe, it can force businesses to recall the product and stop selling it.
- **The Truth-In-Lending Act**. This law requires all banks to calculate credit costs in the same way. When a consumer gets a loan, the lender must provide two types of information about the loan's cost-the finance charge and the annual percentage rate. The finance charge is the total cost a borrower must pay for a loan, including all interest and fees. The annual percentage rate is the finance charge calculated as a percentage of the amount borrowed. These numbers help consumers evaluate alternatives and determine the best option.
- **The Fair Credit Billing Act**. This law is part of the Truth-in-Lending Act and helps consumers correct credit card billing errors. Consumers who feel they have been charged incorrectly must write to the credit card issuer and explain why they think the charge is wrong. The company must reply within 30 days and resolve the dispute within 90 days. While the

disputed charge is being investigated, it cannot accrue interest. This law also gives the consumer a method for resolving problems relating to product quality.

LEGAL ISSUES AFFECTING BUSINESS

It is helpful to learn some basics about legal issues affecting businesses so that you can handle minor legal issues yourself. In other instances, you may want to obtain the services of a lawyer.

CONTRACTS

A contract is a legally binding agreement between two or more persons or parties. As an entrepreneur, you will enter into contracts as you start and operate your business. For a contract to be considered legally binding, certain elements must be included:

- Offer and acceptance occurs when one party offers to do something and the other party accepts or agrees. If the second party makes a counteroffer, however, there is no agreement.
- Genuine agreement means that the agreement is not based on deceit on the part of either party, certain mistakes of fact, or the use of unfair pressure exerted to obtain the offer or acceptance.
- Consideration is what is exchanged for the promise. For example, a payment is consideration and causes the contract to be binding.
- Capacity means the parties are legally able to enter into a binding agreement. Minors, intoxicated persons, and insane persons cannot enter into a binding contract.
- Legality means that a contract cannot have anything in it that is illegal or that would result in illegal activities.

In addition to the elements described above, some contracts must be in writing to be fully enforceable in court. In many cases, however, an oral contract would be enforceable.

TORTS RELATING TO BUSINESS ENTERPRISES

A tort is a wrong against people or organizations for which the law grants a remedy. If someone commits a tort, the person injured as a result can sue and obtain compensation for damages. Torts may occur when manufacturers make defective products that injure users. Certain elements must be proved in a court of law to establish liability:

- Duty. A legal obligation to do or not to do something
- Breach. A violation of the duty
- Injury. A harm that is recognized by the law
- Causation. Proof that the breach caused the injury

AGENCY RELATIONSHIPS

An agency is a relationship that allows one party to act in a way that legally binds another party. The principal is the person who authorizes another person, the agent, to enter into legal relationships on the principal's behalf. One of the most common forms of agency occurs when a salesperson for a business makes a contract with a customer on behalf of the business.

HIRE A LAWYER

At some point, you probably will need to hire a lawyer to assist you with legal issues affecting your business. Your Chamber of Commerce may have a list of lawyers who specialize in small businesses. Other community business owners may also be able to suggest a lawyer.

3-2 Choose a Location and Design the Layout

OBJECTIVES

- ***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

If you want to open a retail business, choosing the location for it will be one of the most important decisions you will make as an entrepreneur. The wrong location could spell disaster, but the right location will help your business succeed from the start.

The right location for your business depends on the kind of business you plan to operate and the type of customer you want to reach. Another factor to consider is whether you will sell your products or services through inside sales or outside sales. If you are selling a product through inside sales, customers will come to your place of business to purchase the product. If you are using outside sales to sell your product, you will travel to the customer's residence or place of business. The way you offer your product or service will affect the location of your business.

Downtown Areas

In some communities, the downtown area represents an easily accessible, central location. Workers from downtown offices and professional businesses may shop at your business on their breaks or on their way to and from work. Rents vary widely from city to city, so you will want to do some research if you are thinking of using a downtown location. Issues faced in many downtown areas include a higher crime rate, traffic jams, lack of convenient parking, and lack of customers in the evening.

Neighborhood Shopping Centers

Neighborhood shopping centers are small shopping centers that serve a certain neighborhood. They are often called strip malls and consist of 3 to 15 stores. They are typically anchored by a supermarket, which is supported by other stores offering convenience goods (food, pharmaceuticals, and miscellaneous items) and personal services. Examples of supporting stores include drugstores, dollar stores, and dry cleaners. Neighborhood centers represent good locations for stores selling goods or services that people need to purchase frequently. Rent is usually low in these centers, making them ideal for small businesses. Customers of neighborhood shopping centers are mainly residents of the surrounding area who shop at these centers because of their convenience.

Community Shopping Centers

Community shopping centers have more square footage than neighborhood centers and are designed to serve residents from many neighborhoods. Apparel, furniture, toy, sporting goods, and electronic stores are often located in community shopping centers. Community centers usually have one or two major anchor stores. Although rent in community shopping centers is generally higher than in neighborhood shopping centers, it is usually still affordable. Stores in community shopping centers can earn higher profits. Anchor stores advertise heavily and attract customers from throughout the community. Other businesses in the shopping center typically benefit from the advertising. Customers shop at the anchor store and then may browse and buy at the smaller stores located in the shopping center as well.

Regional Shopping Centers

Regional shopping centers are designed to attract customers from an entire region. These large shopping areas usually have 40 to 100 stores and are anchored by two or more large department stores, such as JCPenney and Nordstrom. The majority of the stores sell apparel. Many regional shopping centers are malls. Regional shopping centers offer depth and variety of products and services. If your business requires a large amount of walk-in traffic to be successful, you may want to locate in a regional shopping center. Rents at these centers are high, however, making it more difficult to earn profits. Also, the distance to the shop may be too far for some consumers.

Stand-Alone Stores

Stand-alone stores can be located just outside of shopping centers or far away from other businesses. These stores often depend on drive-by traffic. They must have plenty of parking, good signs, and effective lighting if they are to be successful.
Businesses locate in stand-alone locations because rent is often less expensive than it is elsewhere. Also, a competing business is less likely to be right next door. Advertising is often necessary to earn a profit because people must have a specific reason to come to your business. Large jewelers, auto parts stores, and flower and garden centers are often operated as stand -alone stores. A recent trend shows that department stores and large drugstores are opening up standalone stores.

Warehouses

Some retail stores, such as appliance dealers or furniture sellers, operate in warehouses. Warehouses are generally one of the cheapest rental facilities because they are of basic construction with few frills inside or out. Locating your business in a low-rent warehouse may allow you to charge lower prices than your competitors. This can work to an appliance store's advantage because customers are usually more concerned about getting the best price than about the appearance of the business. However, locating away from other retailers can also mean that potential customers will not notice or be aware of you. For this reason, businesses that operate out of warehouses generally advertise heavily.

LOCATING A NONRETAIL BUSINESS

Location can be very important for nonretail businesses, which include service, wholesale, and manufacturing businesses. Owners of these types of businesses face different considerations when choosing a location.

Service Businesses

For some service businesses, such as restaurants and hair salons, location considerations are the same as for many retail businesses because they are offering an inside service. Owners of these types of businesses have to be very careful when choosing a location. Convenience can be an important factor for the business's customers. Location is much less important for other types of service businesses. Customers never actually visit businesses that offer outside services, such as plumbing or carpet-cleaning companies. Locating these kinds of businesses in expensive areas does not make sense. Being close to customers may be important, however, because customers are more likely to call a company located nearby. For example, a computer-repair service might choose to locate downtown to be closer to its customers – the businesses in the downtown area – so it can respond quickly to emergency calls.

Industrial Businesses

Industrial businesses, such as manufacturing and wholesale companies, ship their products directly to their customers, so customers rarely see their facilities. Industrial businesses do not need to operate in upscale locations that attract lots of consumer traffic. Availability of good employees and low cost are the key factors in determining where an industrial business locates. Nonretail businesses sometimes locate in industrial parks. An industrial park is a section of land that is zoned for industrial businesses only. They are usually located where space is less expensive, away from housing developments and downtown areas. Communities sometimes subsidize rents in industrial parks in order to attract industrial businesses.

Home-Based Businesses

In recent years, there has been an increase in the number of home-based businesses. Some of the reasons that entrepreneurs decide to locate their business in their home include the following:

- Cost savings. Separate rent, utility costs, and maintenance fees for the business are eliminated, so there is more capital available for promotional activities and the purchase of inventory.
- More freedom. Home-based business owners do not have to sign a lease agreement for the business, so they are not subject to the restrictions and obligations of a lease.
- Convenience. The owner can work more flexible hours and does not have to commute to and from another location.

Locating a business at home is a great way to save money when starting a business. If the business outgrows its space, the owner can begin to look for an appropriate location outside the home. Although it is cheaper to operate a business from home, there are some disadvantages to operating a home-based business. Lack of space can limit the expansion of the business. It may also be hard to keep your business and family life separate. Many home business owners feel isolated from the business community and miss opportunities to network with colleagues.

STARTING A VIRTUAL OR ONLINE BUSINESS

The widespread use of technology and access to the Internet has changed the way business is conducted. For entrepreneurs, the virtual or online world has created many new business opportunities. E-commerce, or electronic commerce, consists of buying and selling products or services over the Internet.

Benefits of Virtual or Online Businesses

Starting a business online allows a startup business to have an immediate presence and compete with larger, established businesses. A traditional business location limits a startup business because it can only be as big as the physical space it can afford and reach as far as its geographic boundaries. But these barriers do not exist in an online business. The cost of maintaining an online business is much less than the cost of buying or leasing a building. Rather than serving only local customers, a business can reach out to customers globally. Even time restrictions aren't a problem because e-commerce can take place 24 hours a day, including holidays and weekends. Operating an online business can also help with the cash flow problems experienced by many startups. Marketing, customer service, order processing, inventory, and personnel costs are much lower. For example, it is much more cost-effective to use e-mail than direct mailings to reach out to hundreds of customers. Because customers enter their own orders online, employee costs are kept to a minimum. In addition, collecting and managing information about customer behavior is quick and easy for an online business. A customer's movements and selections on the website can be tracked. This information can be used to improve customer relations.

SELECTING YOUR SITE

Given all of the possible types of locations for different types of businesses, how do you decide where to locate? One way of identifying the options for your business location is to buy a map and mark your trade area. The trade area is the area from which you expect to attract customers. Indicate on the map all of the locations that might be appropriate for your business. Also indicate the location of all of your competitors. Using a different color marker or symbol, mark the locations of businesses that do not directly compete with your business but may attract the same kind of customer. For example, if you want to open a poster store that will attract mostly teens, mark the locations of other stores that appeal to this target market, such as trendy clothing stores and music stores.

Location, Type, and Availability

The next step is to identify which type of location is right for your business. Do you want to locate in a community shopping center? A stand -alone store? Downtown? At home? Determining which type of location you want will help narrow your search. After deciding on the type of location, you must determine what spaces of this type are available in your trade area. The classified section of your local paper will list available sites. You can also find locations by driving around your trade area. Signs advertising an available building will often be hung in the front window or placed on the front lawn of the property. Websites and search engines may also be helpful in determining options that are open to you. Mark each possible location you find on your trade area map.

Evaluate the Location

After getting a list of possible locations, inspect each location to assess its appeal. Is the location safe? Is it attractive? Does it attract the kind of customers your business will be targeting? Is it easy to reach? Is parking adequate? Do businesses in the area seem to be thriving? By answering these questions, you should be able to identify one or two viable locations.

OBTAIN SPACE AND DESIGN THE PHYSICAL LAYOUT

Unless you operate your business out of your home, you will have to decide whether to lease or buy business property.

LEASE OR BUY SPACE

There are advantages to buying space. Owning property offers a bigger tax advantage than leasing because you get a tax deduction on the interest you pay on your loan for the building. A loan payment on the building may be no more than a lease payment. However, most entrepreneurs lack the money to purchase property for their businesses. Even entrepreneurs who can afford to purchase property generally prefer not to be locked into a particular location. Some leases require the owner of the building, not the owner of the business, to pay certain expenses, such as upkeep and maintenance of the building's exterior. For these reasons, most businesses lease space.

Commercial Leases

When leasing property, a contract is required. In a lease contract, there is a tenant and a landlord. The tenant is the person who pays rent to occupy space owned by someone else. The landlord is the person who owns and rents out buildings or space. There are three kinds of commercial leases:

1. In a gross lease, the tenant pays rent each month for the space occupied, and the landlord covers all property expenses for that space, such as property taxes, insurance on the building, and building maintenance.
2. A net lease occurs when the landlord pays building insurance, and the tenant pays rent, taxes, and any other expenses.
3. With a percentage lease, the tenant pays a base rent each month, and the landlord also receives a percentage of the tenant's revenue each month. The percentage lease is most common for prime retail locations. This type of lease can be beneficial for both the landlord and tenant. The landlord shares in the business's profits, and the tenant has the advantage of a lower base rent, which can make rent more affordable during slow sales periods.

Commercial lease agreements are usually long and complex. You should never sign one without consulting an attorney. Your attorney will review your lease to make sure that it covers all conditions and costs, including the basic rent, maintenance fees, utility costs, insurance costs, and other items. Once you have selected some possible locations for your business, you need to compare the costs and benefits of leasing property at each location. To do so, you need to calculate how much rent you will be paying per customer.

DESIGN THE LAYOUT OF YOUR BUSINESS

After you have leased or purchased a facility, you will need to design your layout, or floor plan. Your layout must include enough space for employees, customers, merchandise, and equipment. It must also have space for restrooms, stockrooms, storage, and offices.

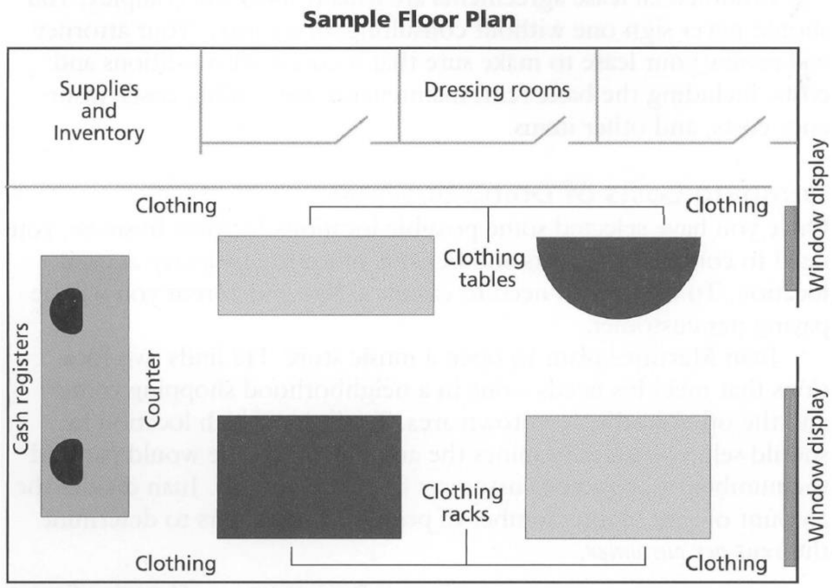
Create the Floor Plan

You will need to prepare a scale drawing of the layout. You can do this by hand or by using online resources, such as Floorplanner.com. Start with the dimensions of the space you leased or purchased. Indicate the planned use of each area within your space. Also indicate the location of furniture, display cabinets, shelves, fixtures, and equipment. Your drawing will help you identify potential problems in your layout. It will also help you communicate with the people who may be helping you organize your space.

Decide on a layout, an outside sign, and window displays that match your image. If you sell expensive jewelry, you will probably decide on a sophisticated outside sign and an elegant inside design that will appeal to your target customer. If you sell outdoor equipment, you will select a very different design for your store.

Layout of a Retail Business

For a retail business, visual merchandising is very important. Visual merchandising is the process of combining products, environments, and spaces into an appealing display to encourage the sale of products or services. The goal of your layout should be twofold: (1) to attract customers to your store and keep them coming back and (2) to meet the needs of your business. Here are some ways you can send a positive message about your store:



- Choose lighting that is appropriate for the kind of merchandise you sell. Good lighting is important for any business where customers inspect merchandise closely. Avoid fluorescent lighting, which creates an unattractive glare.
- Think carefully about window displays. Use them as a way to display new merchandise or seasonal items.
- Make the entrance inviting. An entrance that is welcoming will draw customers into the store.
- Use common sense when organizing the merchandise in your store. Customers should always easily find what they want. Inventory and supplies should also be well organized so that you can find things faster and serve your customers better.
- Leave at least four feet of aisle space. This makes it easy to move around in your store.
- Create attractive in-store displays. Customers are drawn to displayed merchandise.
- Use wall space wisely. Wall space may be too high for customers to reach, but it can be used to display merchandise.
- Place the cash register in a central location. Customers should not have to search for a cashier.

Layout of a Service Business

Service businesses can be divided into two categories.

- Service businesses where people come to the business location to receive a service (restaurants, hair salons, automobile repair services)
- Service businesses that travel to the customer's location and perform the service on-site (exterminators, plumbers, cleaning services)

The layout of the first type of service business should be considered just as carefully as that of a retail business. However, on-site service businesses are never visited by their customers, so an attractive layout is not important. Organization should be a major consideration of on-site service businesses so that supplies and other items are easy to find.

Layout of a Wholesale Business

Customers of wholesale businesses are concerned with price and quality, not physical appearance. For this reason, a wholesale business needs only to have an efficient and well-organized layout. Wholesalers are constantly receiving and shipping large volumes of products. Wholesale businesses can do the following to facilitate shipping and receiving:

- Locate in a one-story warehouse.
- Keep merchandise close to the shipping dock. This minimizes the distance it will have to be moved when it is brought into and taken out of the warehouse.
- Store the most popular items in the most accessible locations.
- Be sure there are areas that can accommodate merchandise of all sizes.

- Keep walkways free of merchandise so that employees can exit the building quickly in an emergency.
- Store items safely. For instance, do not stack too many boxes on top of one another because they may fall if they become unsteady.

Layout of a Manufacturing Business
For manufacturing businesses, the layout should facilitate the production process. Attractiveness does not count. Important considerations include the following:
- Work teams should be situated close together.
- Supervisors should be able to easily observe the people they supervise. Their office should be located near the employees.
- Exits should be clearly marked and easily accessible so that employees can quickly leave in the event of an emergency.
- Any hazardous materials should be stored safely.
- Equipment and machinery should be positioned in a way that reduces the chance of an accident.

3-3 Purchase Equipment, Supplies, and Inventory

OBJECTIVES
- ***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. Machinery, computers, cash registers, and furniture are types of equipment. Supplies include things like paper, pens, and pencils. Inventory consists of the products and the materials needed to make the products that a business sells to its customers. Without these things, a business cannot function properly. If there is no inventory, what will you sell? If there is no paper, how will you send a letter? Suppliers or vendors can provide your business with everything you need to function.

To determine the equipment and supplies you need to start your business, make a list of what you think you will need. All businesses need standard items such as furniture, lamps, and office supplies. Businesses also need goods specific to the type of business. For example, lawn-care companies and landscaping firms would need lawn fertilizer as part of their supplies and lawn mowers as part of their equipment. Your list should include standard items needed by all businesses as shown in the table below. It should also include items specific to your particular business.

Once you have listed all of the items you need, indicate how much of each item you require. Be sure to list the minimum quantity you need right now, not the amount you might need if your business succeeds. Being overly optimistic could leave you with many bills that will be difficult to pay if your sales fall short of your projections.

Identify Suppliers and Evaluate Proposals
To fill the standard and special needs of your business, you will need to research vendors. Vendors are companies that sell products and services to businesses. Vendors are also called suppliers. Most of the items you will need to start your business will be available from a variety of vendors. How will you decide among them? Before you make a purchase, contact several vendors and ask them to quote you a price for the merchandise you are interested in purchasing. A quote is an estimate for how much you will pay for the merchandise or service. Also ask vendors about the quality of their merchandise, their financing terms, quantity discounts, and shipping and handling charges. Once you have all the information you need, compare the various proposals. Choose the vendor that provides the best combination of products at a cost that fits your budget.

STANDARD EQUIPMENT AND SUPPLY NEEDS FOR MOST BUSINESSES

Type	Items
Furniture	Desks, chairs, bookcases, filing cabinets, tables, computer stands
Fixtures	Lamps, overhead lights
Office Equipment	Computers, routers, modems, fax machines, telephones, printers, copiers, scanners
Office Supplies	Stationery, pens and pencils, scissors, tape, staplers, paper clips, binder clips, folders, calendars
Maintenance Supplies	Toilet paper, paper towels, hand soap, cleaning supplies
Kitchen Supplies	Coffee maker, small refrigerator, soft drinks, coffee, tea

Purchase Inventory
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.

Purchase Inventory for a Startup Business

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.

Chris Keating wants to open an art supplies store. He wants to have enough inventory that his shelves look full. He also wants to be able to offer his customers a full line of art supplies. Not knowing how high or low his sales will be at first, Chris doesn't want to purchase too much inventory. He doesn't want to tie up his cash in inventory if he can't sell it quickly. Chris is also worried about finding space to store the inventory. Because of these concerns, Chris purchases just enough stock to fill his shelves.

Purchase Inventory for an Ongoing Business

Once your business is up and running, you will have a better idea of how much inventory you need. To make sure that you do not run out of stock unexpectedly, you should track it and establish reorder points for each product you sell. The reorder point is a predetermined level of inventory that signals when new stock should be ordered. How low you set the reorder point depends on how long it takes your supplier to get merchandise to you, how many units of the item you sell each month, and how important it is for you not to be out of stock.

Chris sells 150 erasers a month. Because he never wants to be out of stock, he sets his reorder point at 30. Every time his inventory of erasers falls at or below 30 units, he places an order to renew his stock of this item.

3-4 Identify Your Staffing Needs

OBJECTIVES

- ***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

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. Good employees and a well-run human resource management program are as important to your business as are capital, equipment, and inventory.

Staffing involves determining the number of employees you need and defining a process for hiring them. To find out your staffing needs, ask yourself these questions:

- What kinds of employees do I need?
- What skills am I missing?
- What skills do I need daily?
- What skills do I need occasionally?

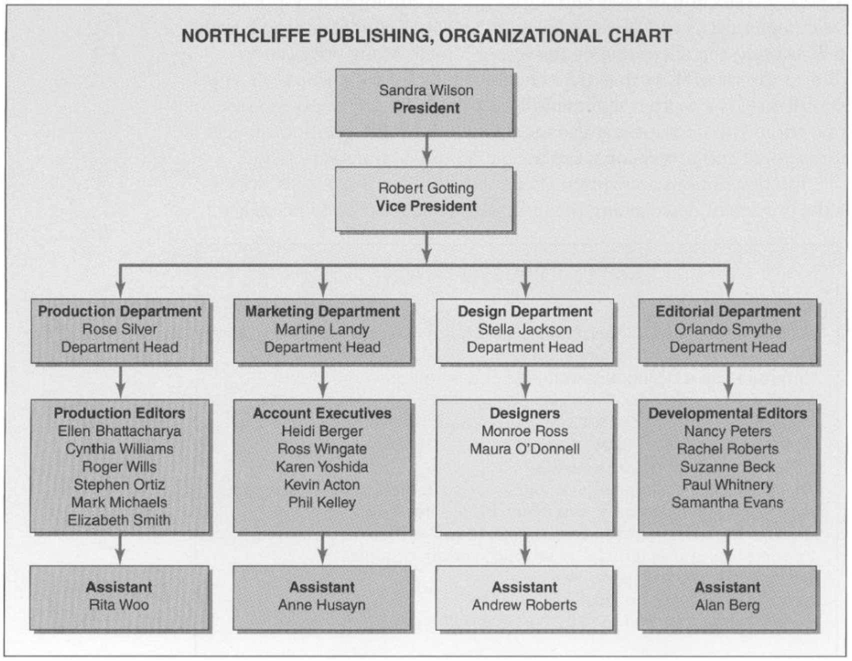
To answer these questions, list all the duties in your business. Then try to identify how much time is needed to perform each of these duties. Your list should help you identify whether you need part-time, full-time, or temporary workers. You can also determine whether you need managers or assistants and how many employees you need.

SAMPLE JOB DESCRIPTION

Title: Account Executive
Tasks and Responsibilities: Plans, coordinates, and directs advertising campaigns for clients of advertising agency. Works with clients to determine advertising requirements and budgetary limitations. Coordinates activities of workers engaged in marketing research, writing copy, laying out artwork, purchasing media time and space, developing special displays and promotional items, and performing other media-production activities.
Qualifications: College degree with courses in marketing, leadership, communication, business, and advertising; sales experience; interpersonal and written communication skills; neat professional appearance; characteristics of self-motivation, organization, persistence, and independence
Reports to: Marketing Manager
Salary Range: $30,000 to $50,000, depending on experience

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. Many positions include a variety of tasks that are sometimes referred to as functions. A job description is a written statement listing the tasks and responsibilities of a position. Job descriptions also include to whom the position reports, educational and professional experience required, and salary range. Job descriptions are written after conducting a job analysis, which is the process of determining the tasks and sequence of tasks necessary to perform a job. You will need to understand exactly what every job involves so that you can determine how much money to offer job applicants. A detailed job description will make clear the job responsibilities. If a sales assistant objects to answering phones, you can refer that employee to the job description that lists this task as part of the job. Job descriptions also can be used to measure how well an employee performs a job.



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. The organizational chart can also help you analyze your staffing needs. Using the chart during planning can help you identify the number and types of employees you need. When planning, you can list positions and primary responsibilities of each. Then as employees are hired, you can fill in the names.

The organizational chart shows the chain of command, or who reports to whom in the company. In a small business, all employees may report directly to the company owner. In large companies, lower-level employees usually report to a supervisor. This kind of organizational structure ensures that the owner is not called upon to deal with relatively unimportant issues that could be handled more efficiently by a lower-level manager.

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. They will have opportunities to work for larger, established businesses that can offer them higher pay and better benefits. You can use a variety of resources for recruiting, including online career and employment sites, employment agencies, college placement centers, in-store advertising, classified advertisements, and referrals.

Alternatives to Adding Staff

Adding employees to your payroll is costly. It takes time and money to recruit staff and to track, report, and pay their salaries, benefits, and tax withholdings. In many cases, you may need help but not have sufficient work to keep a permanent full-time employee busy. For these reasons, you may want to consider alternatives to permanent employees, such as hiring freelancers, interns, and temporary workers.

THE HIRING PROCESS

Hiring the best people available and retaining them is important for the success of your business. Working conditions in a small business are different from those in a large corporation. Employees in a small business are closer to the founder and owner of the company, and there is usually more variety and freedom in the work environment. However, there are also drawbacks to working for a small company. Mistakes are more obvious, and there is less support for legal and human resource issues. Hiring employees is often difficult because it requires making very important decisions based on fairly limited information. How should you decide whom to hire? The four-step hiring process involves (1) screening candidates, (2) reviewing and verifying information on job applications, (3) interviewing the best candidates, and (4) making a job offer.

Screen Candidates

The first step in the hiring process is to screen candidates to remove people who are not right for the job. This allows you to focus on the most qualified candidates. The job description identifies the specific qualifications needed to perform a particular job. You need to match the job candidate's experience and skills with the job description. You should also look for personal characteristics that would make a person a desirable employee.

Michael Johnson, owner of Johnson's Medical Supply, ran a want ad in the local newspaper. He was looking for a person with at least five years of experience selling medical equipment. He received more than 150 responses to his ad. However, 120 of the resumes he received were from people with no experience in the field. Michael immediately removed those from the stack of possibilities. Next, he carefully examined each resume and cover letter and selected ten candidates to interview based on their experience.

Review and Verify Information on Job Applications

You will need to have potential candidates complete an application. There are standard application forms that you can use, or you can design one that will meet your specific needs. The application allows you to gather information that might not be included on a resume. If you decide to design your own application, you can use the job description as a guide to gather the information you need about the candidate's experience.

Once you have applications and resumes from candidates, you need to verify that the information provided is correct. The first thing you should do is check references. Call previous employers to make sure the applicant held the positions listed on the resume. Ask what they can tell you about the person. Describe the job opening and ask the previous employers if the candidate would perform well in such a position. Other questions can revolve around the personal qualities of the candidate, such as interpersonal skills and punctuality. Request that the candidates provide an official transcript from schools they attended to verify education and training.

Interview the Best Candidates

The job interview provides you with the opportunity to determine whether a prospective employee would improve your ability to meet customer needs. It is also your chance to make your small business appealing to a prospective employee. Making the most of the job interview is as important for you as it is for the job candidate.

Sell Your Business. During the interview, make your small business appear inviting and appealing to prospective employees.

- Share your values and plans for the business. Help the applicant understand your vision for the business.
- Talk about the significance of working in a new business. Emphasize the importance of the contributions the applicant would make in the development and growth of a new business.
- Explain the atmosphere in which the candidate would work. Make sure the applicant understands that a small business can foster an environment of flexibility and caring. Some people would rather work in a small business that is not as structured as a large corporation.
- Describe your bonus system. With a small startup business, you may not be able to pay a large salary, but you can offer an attractive bonus or benefits package. Explain that if the business does well, you will share some of the profits with those who help you succeed.

SAMPLE INTERVIEW QUESTIONS

1. What interests you about the job?
2. How can your skills and experience benefit the company?
3. What are your career plans? How does this job fit in with those plans?
4. What other positions have you held? What did you like and dislike about those positions?
5. What were your achievements at your previous jobs?
6. Why did you leave your last job?
7. How do you think your education has prepared you for this job?
8. What kind of work do you enjoy most? What makes a job enjoyable for you?
9. Describe a situation where you had to manage conflicting priorities.

Make The Interview Effective. To ensure that you use your time during the interview effectively, follow these basic rules:

- Be prepared. Make a list of open-ended questions you want to ask. Review the job candidate's resume and application again just before the interview begins.
- Be courteous. Do not be late for the interview. Avoid taking phone calls during the interview. Try to put job candidates at ease by offering them something to drink. Make them feel welcome in your office.
- Avoid dominating the interview. Remember that the interview is your opportunity to get to know the job candidate. To do so, be sure to allow the applicant plenty of time to speak.
- Take notes. Throughout the interview, jot down your impressions of the candidate as well as any interesting information he or she reveals.
- Look for warning signs. Signs that a person may not be a good worker include frequent job changes, unexplained gaps in employment, and critical comments about previous employers.
- Don't make snap judgments. Don't rule out a candidate until the interview is over.
- Remain pleasant and positive throughout the interview. At the end of the interview, thank the candidate for coming and let him or her know when you plan to make a decision.
- Write a summary of your impressions of the candidate. Write your summary immediately after the interview while your thoughts are still fresh. Put this document in the candidate's file.

Make a Job Offer
When you have decided to make a job offer, contact the person by phone. Let the person know you were impressed with his or her credentials. Be sure to emphasize how much you would like the applicant to join your company. Clearly state the starting salary, benefits, and terms of employment. If the first applicant declines your offer, extend the offer to your second choice and then to your third choice, if necessary. Once a candidate accepts your offer, contact the remaining candidates. Thank them for interviewing with your business and politely let them know that you have given the job to another applicant.

COMPENSATION PACKAGE

As an entrepreneur with paid employees, you will need to create a compensation package. The package will include some type of pay and may also provide a variety of benefits. The benefits package can influence a candidate's decision on whether or not to take a position with a company.

Types of Pay
There are many ways you can choose to pay your employees. The terms "wages" and "salary" are often used interchangeably, but there is a difference. Wages are payments for labor or services that are made on an hourly, daily, or per-unit basis. The paycheck for a person earning a wage will vary depending on how many hours are worked or how many units are manufactured. A salary is an amount paid for a job position stated on an annual basis. Regardless of the number of hours the person filling the position works, the amount of money the salaried employee is paid does not vary. Wages and salaries can be paid weekly, biweekly, or monthly.

Employees may also receive a bonus, which is a financial reward made in addition to a regular wage or salary. Bonuses usually hinge on reaching an established goal. Profit sharing is another compensation arrangement in which employees are paid a portion of the company's profits. Some employees are on commission-based salary plans. A commission is a percentage of a sale paid to a salesperson. A commission-based salary varies from month to month depending on sales. Those receiving this type of salary may be paid using a commission-only plan (all of the salary is paid in commission) or a combination plan (includes a base salary plus commission).

Pay Competitively. In most markets, wages and salaries are competitively determined. This means that an employer who offers much less than the going wage or salary rate is not likely to find qualified workers. To offer competitive wages or salaries, you will have to find out how much similar businesses in your area are paying their employees. You should also find out what people are earning in jobs with similar qualifications. Once you know the going wage or salary rate, you will have to decide whether you want to offer more than, less than, or about the same as other businesses. Offering more than other businesses will attract the best employees.

Benefits
Benefits are rewards, other than cash, given to employees. They may include paid leave, insurance, and a retirement plan:

- Paid Leave. Almost all employers offer paid vacation and sick time. Both kinds of leave represent costs to employers because employees are paid while they are not working. Be aware that some employees may abuse paid leave. You or someone in your business should keep a record of the paid leave employees take and watch for patterns that might indicate abuse. Businesses handle vacation in various ways. Many offer one or two weeks of paid vacation a year to new employees. Employees usually gain more vacation time the longer they work at a business. Some businesses let employees carryover unused vacation days from year to year while others require employees to use their vacation time each year. Sometimes your employees will not be able to work because of illness. The number of days of sick leave provided varies from business to business. Some businesses offer only five sick days a year. Others allow employees unlimited sick leave. You will have to develop a sick leave policy that is fair to your employees but not too costly to you.
- Insurance. Many businesses offer health insurance as a benefit to full-time employees. The cost to small businesses to provide insurance coverage can be quite high. Large businesses receive discounted group rates but may still require employees who opt for this benefit to pay a portion of the cost. Businesses may also offer other kinds of insurance, such as dental insurance, life insurance, and accident and disability insurance.
- Retirement Plans. Some businesses help employees save for retirement by offering 401(k) plans. Employees that participate in 401(k) plans have a percentage of their earned income withheld by the employer to be deposited into a professionally managed investment account. Some employers will match employees' 401(k) contributions as much as 50 cents per dollar invested. The funds will continue to grow tax-free until they are withdrawn by the retiree upon reaching retirement age. Pension plans are another type of employer-sponsored retirement savings plan, but they are not as common because they are more costly to a company.

REGULATIONS THAT PROTECT EMPLOYEES

There are many laws designed to prevent discrimination and promote health and safety in relation to employment. It is important to consider these regulations as you develop your staffing plan. Small businesses often run into human resource management issues because the person doing the hiring is not a trained personnel specialist who is familiar with these laws.

- **National Labor Relations Act (NIRA)**. Congress passed the National Labor Relations Act (NLRA) to protect the rights of employees and employers in the process of negotiating employment contracts. It guarantees workers the right to join a union, which is an organization that represents employees and bargains on their behalf for better working conditions and terms of employment. The contract negotiation process between employer and union is known as collective bargaining.
- **Fair Labor Standards Act (FLSA)**. The FLSA defines the employment relationship between an employee and employer. It distinguishes between an employee and an independent contractor, who has a business of his or her own. When an employee relationship exists as defined by the FLSA, the employee must be paid at least minimum wage. The act established the national minimum wage. The FLSA also establishes the maximum number of hours employees can work. It requires that employees earn overtime pay for hours worked in excess of 40 hours a week. In addition, the act includes rules for workers under the age of 16.
- **Civil Rights Act**. Title VII of the Civil Rights Act prohibits discrimination on the basis of race, color, religion, sex, or national origin in hiring, promotion, discharge, pay, fringe benefits, job training, classification, referral, and other aspects of employment. The Civil Rights Act also includes protection against sexual harassment.
- **Age Discrimination in Employment Act**. The purpose of this act is to promote employment of older persons (40 and over) based on their ability rather than their age. It prohibits arbitrary age discrimination in employment and helps employers and workers find ways of resolving issues that arise from the impact of age on employment.
- **Occupational Safety and Health Act (OSH Act)**. The OSH Act requires that employers maintain safe working conditions for their employees. To comply with the act's regulations, you must keep records that show the steps you have taken to protect the welfare of your workers and to keep your workplace safe. If employees have to work with dangerous equipment or substances, you must provide them with special training.
- **Immigration Reform and Control Act**. This act requires that employers check the identification of employees hired after 1986 to ensure that they are legal citizens of the United States. It also established the Office of Special Counsel for Immigration-Related Unfair Employment Practices to enforce antidiscrimination provisions.
- **Americans with Disabilities Act (ADA)**. The ADA bans discrimination against employees based on disabilities. It requires businesses with 15 or more employees to accommodate the needs of employees with disabilities, even if the firms currently do not have disabled employees. The intent of the ADA is to protect job applicants and employees who are legally disabled but are qualified for a specific job. An employee is qualified if he or she can carry out the necessary functions of the job with some type of reasonable accommodation.
- **Family and Medical Leave Act**. This act requires businesses with more than 50 employees to provide employees up to three months of unpaid leave if a serious health condition affects the employee, the employee's child, or the employee's parent or spouse. This act also makes it possible for male and female employees to take leave in the event of a birth or adoption of a child. To be eligible, an employee must have been employed by the business for at least one year.

3-5 Business Risks

OBJECTIVES

- ***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

Risks can be categorized as human risk, natural risk, and economic risk:

- Human Risks. Human risks are those caused by the actions of individuals, such as employees or customers. Examples include shoplifting, employee theft, robbery, credit card fraud, and bounced checks.
- Natural Risks. Natural risks are caused by acts of nature. Examples are storms, fires, floods, and earthquakes. The occurrence of any of these could bring about tremendous loss to a business.
- Economic Risks. Economic risks occur because of changes in business conditions.

PREPARING TO FACE RISKS

As an entrepreneur, you must be prepared to face all kinds of risks. You will need to decide the best strategy to deal with risks:

- Avoid/Reduce the Risk. You may decide to avoid or reduce the risk. For example, if you think a product you are developing will not meet market needs, you may decide to avoid financial risks caused by low sales by halting production of the product.
- Assume the Risk. You may decide to assume the risk if you determine the risk is low. If your market research indicates the product you are developing will be successful with your target market, you will most likely produce and sell the product even though there is still a chance of lower sales than expected.
- Transfer the Risk. Transferring the risk is another option. You will be able to protect yourself against the financial losses from some risks by purchasing insurance. Insurance transfers the risk of financial loss to the insurance company. You never know when a disaster may strike, but you should have a plan of action in place when it does.

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.

Develop A Plan

Once you have identified the risks that could affect your business, you should develop a written plan for dealing with them. When developing a risk management plan, you may have to comply with certain laws. For example, OSHA (Occupational Safety and Health Administration) requires businesses to have an evacuation plan for emergencies. Be sure to have a recovery plan in place if you suffer a setback. A recovery plan will enable you to get back to business as quickly as possible. If you suffer a loss due to a fire, have a plan for temporarily relocating, getting replacement equipment, and retrieving lost data. If one of your suppliers is out of stock of a component needed in the production of your product, have another supplier lined up. A recovery plan will help you continue to meet your customers' needs. Review your risk management plan periodically. As your business develops and grows, risks facing your business may change. Revise your risk management plan to accommodate your changing needs.

Communicate Your Plan

Let your managers and employees know about your plan for handling risks. To ensure your plan is carried out properly, assign activities and responsibilities to the appropriate people. For example, to protect against the risk of a faulty product, assign the production manager the task of checking the quality of the finished product. If you plan to run an advertisement for an upcoming sale, make sure someone is responsible for placing the ad in the appropriate media at the appropriate time to avoid the risk of lost sales. Work with your managers and employees to be sure all risks are addressed.

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.

Shoplifting

Shoplifting is the act of knowingly taking items from a business without paying. Customers shoplift millions of dollars in merchandise every year. The problem exists in virtually every type of retail business. If you own a retail business, you will have to take steps to prevent or reduce shoplifting. Some of the things you can do include the following:

- Instruct your employees to watch for customers who appear suspicious.
- Hire security guards or off-duty police officers to patrol your store.
- Post signs indicating that you prosecute shoplifters.
- Ask incoming customers to leave their bags behind the counter.
- Install electronic devices, such as mounted video cameras, electronic merchandise tags, and point-of-exit sensors, to detect shoplifters.

Employee Theft

Most employees are hard working and honest, but there are a few who will take things from your business, such as office supplies, equipment, merchandise, and even money. These employees can negatively impact your business financially. As an entrepreneur, you need to be aware of the possibility of employee theft. You need to take steps to prevent the problem from occurring. You also need to know how to detect the problem and to handle it once it is detected. Some businesses, such as restaurants and retail stores, are more vulnerable to employee theft than others. If you own such a business, you may need to adopt the following procedures:

- Prevent dishonest employees from joining your company. Screen job applicants very carefully. Consider using a company that specializes in verifying job applicants' educational backgrounds and searching their criminal records, driver's license reports, civil court records, and credit reports.
- Install surveillance systems. Often the mere knowledge that they are being filmed by a video camera deters employees from stealing.
- Establish a tough company policy regarding employee theft. Your company policy should detail the consequences of employee theft. Make sure that all employees are aware of the policy.
- Be on the lookout. Watch for cash discrepancies, missing merchandise or supplies, vehicles parked close to loading areas, and other signs that something may be wrong. Keep an eye on employees who seem to work at odd hours, perform their jobs poorly, or complain unreasonably. Make inquiries if an employee has an unexplained close relationship with a supplier or customer or has a personal lifestyle that seems inconsistent with his or her salary.

Robbery

Almost all businesses are vulnerable to robberies. You can choose what is considered a safe area of town to locate your business to guard against being robbed. You can also install dead-bolt locks and burglar alarms. To limit losses in the event of a robbery, many businesses keep a minimal amount of cash in the cash register. Once more than a certain amount is received, the cash is transferred to a safe. Some businesses also use surveillance cameras, which deter prospective robbers from entering the business in the first place. Be aware that you may be robbed regardless of the number of preventative measures you take. It is simply a risk of being open for business.

Credit Card Fraud

Business owners lose millions of dollars every year because of stolen credit cards. If a purchase is made on a stolen credit card, a business may not be able to collect the money. To prevent stolen credit cards from being used to purchase goods, you can install an electronic credit authorizer. This machine checks to see if a credit card is valid. If the card has been reported stolen or if the cardholder has exceeded the credit limit, authorization will not be granted.

Bounced Checks

A bounced check is a check that the bank returns to the payee (the person or business to whom the check is made payable) because the check writer's checking account has insufficient funds to cover the amount. Bounced checks are also called bad checks. Preventing losses from bad checks is difficult. To minimize losses, you can establish a policy of accepting checks drawn on in-state banks only. You can also charge a fee if a customer writes a bad check to your business. Asking for identification, such as a driver's license, can help you track down a person who writes you a bad check so that you can collect the money due. If bad checks are a serious problem in your area, you may decide not to accept checks at all.

3-6 Insure Against Risks

OBJECTIVES

- ***Identify risks faced by business owners and explain why some business risks are uninsurable.***
- ***Determine the different types of insurance you need for you business.***
- ***Explain how to manage credit risks and other risks at work.***

CLASSIFICATION OF RISK

As a business owner, you are at risk from more than just criminal activity. A fire could destroy your building. An accident could injure an employee. A broken water pipe could ruin your inventory. One precaution you can take to protect against financial loss is to purchase insurance. A payment made to an insurance company to cover the cost of insurance is a premium. It is the price paid to cover a specified risk for a specific period of time. Business owners face many types of risk. The classifications of risk are based on the result of the risk, controllability of the risk, and insurability of the risk.

Result of the Risk

A pure risk presents the chance of loss but no opportunity for gain. If you have a vehicle that is used in your business, every time it goes out on the road there is the risk of an accident. If there is an accident, a loss will likely be suffered. However, if an accident is avoided, there is no opportunity for gain. A speculative risk offers you the chance to gain as well as lose from the event or activity. Investing in the stock market is a good example of a speculative risk. When you invest money, you have the chance to make money if the stock price rises. However, if the stock price falls, you risk the chance of losing money.

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. If a hurricane hits a resort town, a dramatic decrease in business and loss of profit will result. But if the weather is sunny and warm, tourism will flourish and business owners may make a profit.

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. Buildings that house businesses are susceptible to fire. Nearly all businesses face this risk, and past statistics can help insurance companies predict the amount of loss and percentage of businesses that will suffer fire losses annually. Insurance companies can sell fire insurance to help cover losses. The premiums of all those insured are pooled and used to help those who incur losses. If there is a risk that a loss will occur and the amount of the loss cannot be predicted, the risk is uninsurable. An insurance company would have no way of determining the premiums to charge or the amount of funds to pool to cover unpredictable losses. A business may move to a new location, and customers may not follow. The loss of income that could result cannot be predicted and, thus, is not insurable.

UNINSURABLE RISKS

Sometimes things happen in the business world that are not covered by insurance, which can be very costly to a business. Insurance does not cover risks that cannot be reasonably predicted or for which the financial loss to the business cannot be calculated. These risks are tied to economic conditions, consumer demand, competitors' actions, technology changes, local factors, and business operations.

Economic Conditions
Managers must constantly study economic conditions. Changes in economic conditions can result from an increase or decrease in competition, shifts in population, inflation or recession, and government regulations. World events can also result in economic changes. The terrorist acts of September 11, 2001 caused a dramatic downturn in the U.S. economy, resulting in major cutbacks and layoffs by businesses. This decreased the amount of disposable income for many Americans, which resulted in losses for many entrepreneurs. When the economy takes a downward turn, a business must respond quickly by cutting production and expenses.

Consumer Demand
Businesses produce products and services that they think consumers want to buy. Business owners must research consumer needs and wants. If they can predict a change in demand, they may be able to profit by producing and selling a new product or service. However, if consumer demands change suddenly, the company may end up with products in its inventory that it cannot sell.

Competitors' Actions
Business is competitive. As a business owner, you must be aware of your competitors and their actions. A major advertising campaign or a drop in price by your competitors may result in a change in your volume of sales. You must be ready to respond to actions by your competitors to minimize the risk to your business.

Technology Changes
Changes in technology bring about changes in business. As a business owner, you need to stay up to date on technology trends. Evaluate new technology and see if it can help your business. Updates to technology can be a major expense but can alternatively provide efficiencies and help you serve customers better. If customers view your business as outdated, you may lose customer loyalty and sales to your competition.

Local Factors
Businesses can suffer due to activities that occur in their local community. If there is an increase in local taxes or a change in local business regulations, it can affect your business. If a local government makes improvements to the infrastructure, such as road or utility improvement, it can help your business in the long term. In the short term, it may result in a loss of business because ongoing construction could cause customers to detour around your business.

Business Operations
The management of a business contributes directly to the success or failure of the business. A business that is poorly managed can have high employee turnover, poor customer service, higher expenses, and other problems. Poorly trained employees can also cause operational problems. Managers and employees must work together to ensure the success of the business.

TYPES OF INSURANCE

Purchasing insurance is one of the best ways you can prepare for the unexpected. There are many options for insurance. You will have to examine the risks you identify and their potential impact on your business to determine if you need to insure against the risk.

Business Insurance
Insurance companies selling business insurance offer policies that combine protection from all major property and liability risks in one package. These coverages are also sold separately. Package policies are created for businesses that generally face the same kind and degree of risk. Large companies might purchase a commercial package policy or customize their policies to meet the special risks they face. Many small and mid-sized businesses purchase a package known as a business owner's policy (BOP), which typically includes the following:

- Property Insurance This type of insurance provides coverage for damage to buildings and the contents inside the buildings, such as furniture, fixtures, equipment, and merchandise owned by the business.
- Business Interruption Insurance This type of insurance covers the loss of income resulting from a fire or other catastrophe that disrupts the operation of the business. It can also cover the extra expense of operating out of a temporary location.
- Liability Protection This type of insurance covers your company's legal responsibility for the harm it may cause to others as a result of what you and your employees do or fail to do in your business operations. Harm may involve bodily injury or property damage due to defective products, faulty installations, and errors in services provided.

BOPs do not cover auto insurance, workers' compensation, or health and disability insurance. They also do not cover professional liability, which involves claims of negligent actions by business professionals such as doctors. You will need separate insurance policies to cover these items.

Life Insurance
Life insurance is paid in the event of the death of the insured. It is intended to provide financial support for families should the income earner die. A business owner may buy life insurance so that his or her heirs have enough money to continue the business.

Other Kinds of Insurance
Other types of insurance that you may want to purchase include flood, crime, and renter's insurance. Flood protection is not standard with property insurance, so you may have to purchase it separately. Crime insurance protects against losses resulting from crime, such as robbery, computer fraud, or employee theft. Renter's insurance covers the contents owned by the renter inside the leased space. The actual owner of the building would purchase insurance for the building. Depending on your business and its location, you mayor may not decide to purchase these additional kinds of protection.

Determine How Much Coverage You Need
To determine the kinds and amounts of coverage you need, start by making a list of the property you own. Include equipment, inventory, vehicles, and other significant assets, and put a value next to each. Then think about the lands of risk you would want to insure against. If, for example, your business is located near a river, you may want to purchase flood insurance. If you live in a low-crime area, you may decide against insurance that covers break-ins. Understand, however, the implications of not having insurance if something should happen. The next step is determining how much coverage you need. Be sure you have enough insurance to cover any and all debts you may have incurred while starting your business.

Buying insurance can be complicated. Is it possible to have too much or too little insurance? A good insurance agent can help you make decisions about insurance coverage.

RISKS OF CREDIT

As a business begins operation, there will be costs that will be too expensive for the entrepreneur to pay all at once. Credit makes it possible for the entrepreneur to make these costly purchases. The business owner will also have to make decisions about extending credit to customers. When a business extends credit to customers, it is entering into a voluntarily created debtor-creditor relationship. For example, when a person purchases an appliance and finances the cost, the business and purchaser now have a debtor-creditor relationship. Examples of voluntarily created debtor-creditor relationships include loans of all types, credit lines, and the use of credit cards. Involuntarily created debtor-creditor relationships also exist. For example, if the delivery driver of a small business is at fault in a traffic accident and injures someone, the business can be required to compensate the injured person. These types of risks can be minimized through insurance, however.

Debtor-creditor relationships that involve extending credit can help increase a business's sales. However, a business will need to decide if extending credit will result in an overall is useful to a business when buying or selling, there are risks involved. It is important for you as an entrepreneur to understand these risks.

Types of Credit

Credit can be categorized according to whom the credit is offered. Like bank loans, the credit a business offers its customers can be secured or unsecured.

Trade Credit. When one business allows another business to buy now and pay later, it is offering trade credit. Many purchases a business owner will make from other businesses will be made with trade credit. The negotiated price of products purchased on trade credit will often be higher than the cash price. This is necessary because there is a lapse of time that occurs from when the sale is negotiated to when the products are actually delivered and the supplier is paid. Because of this delay in receiving payment, the supplier charges a higher price. As the business owner, you will need to be sure that you have the money to cover your expenses when they are due in order to protect your credit record.

Consumer Credit. When a retail business allows its customers to buy merchandise now and pay for it later, it is offering consumer credit. Consumer credit is offered in two basic forms: loans and credit cards. A loan gives the individual a lump sum of money to spend and pay back over time with interest. If a loan is secured, it is backed by something of value that can be taken and sold if the loan is not repaid. One type of secured loan offered by retail establishments is an installment loan that is paid back with interest in equal monthly amounts over a specified period of time. Many cars and home appliances are financed with installment loans, with the financed item serving as the collateral.

An unsecured loan is granted based on the credit history of the individual. This type of loan is not backed by collateral. Most credit cards are considered unsecured loans. When a business offers its own credit card to customers, it will not receive payment for a month or more after the sale is made. Therefore, the business will need to make other arrangements to ensure it has money to cover expenses associated with the sale of the merchandise. If the customer does not pay, then the business owner can attempt to collect the money or take back the goods that were purchased.

Collection difficulties are one reason a business chooses to accept credit cards that are issued by banks or credit card companies, such as Visa, Discover, or MasterCard. The credit card company will pay the business for the amount of the purchase. The business is charged a fee by the credit card company that is a percentage of total credit sales. The credit card company is then responsible for collecting the amount charged from the customer.

Credit Policies

Once an entrepreneur decides to offer credit, policies must be established to help reduce risks. Policies should specify to whom credit will be extended, what products may be purchased on credit, and what the terms of the credit will be. The terms include the amount of credit, the rate of interest charged, and the length of time before payment is required.

It will be very important for the entrepreneur to determine what type of customer will be approved for credit. Most businesses offering credit cards have customers complete a credit application to determine whether they are creditworthy, or able to pay. Some things to consider in determining who is creditworthy include the following:

- Previous credit history
- Employment record
- Assets owned
- Money available for making payments (checking and savings accounts)
- Financial references

Even though a business is careful about deciding which customers are creditworthy, there is still the risk that some customers will not pay their account balances, resulting in uncollectible accounts. If credit is extended to individuals who are not able to pay, the business loses all the money invested in the product. If the product is recovered, money will still be lost because used merchandise cannot be resold at the original selling price.

Businesses and credit card companies usually charge the customer interest on the balance due to cover the cost of the credit service. When accounts are paid on time, the interest is income for the business. However, uncollectible accounts are an expense to the business and decrease net income. Collection procedures must be established and followed carefully. This will ensure that customers are billed on time. Procedures should state how to handle customers who do not pay on time or do not pay at all.

RISKS ON THE JOB

Different occupations have different risks associated with them. Due to the nature of the work that is performed, some workplaces are considered to be dangerous. Some of the most dangerous occupations in America include timber cutters and loggers, commercial pilots, construction and iron workers, trash collectors, farmers and ranchers, roofers, electrical power line installers, and cab drivers. Other occupations, although not classified as dangerous, do have risks associated with them. Individuals who work in hospitals can be exposed to viruses and bacteria that can cause disease or infection. Night clerks can be a target for a robbery. Even using a computer for long stretches of time can cause injury. Repetitive stress injuries result from performing the same activity repeatedly for long periods of time. They can be very painful and cause disabling injuries. With some exceptions, any harm suffered by employees at the workplace is considered to be a work-related injury.

WORKERS' COMPENSATION

The Federal Employees' Compensation Act (FECA) is a law that provides benefits to employees who have suffered work-related injuries or occupational diseases. These benefits include payment of medical expenses and compensation for lost wages. FECA also provides for payment of benefits to dependents of employees who die from work-related injuries or diseases. Employers are required by law to carry insurance to protect against these risks. This insurance is called workers' compensation. The expense for this insurance is entirely the employer's responsibility. No part of this insurance expense is paid by an employee.

Workers' compensation laws vary from state to state but generally provide for the payment of medical bills, a percentage of lost wages, and vocational retraining if an employee is unable to resume his or her former job. Workers' compensation will also pay a death benefit to compensate survivors if an on-the-job injury results in the death of a worker.

Once employees accept workers' compensation benefits, they cannot sue their employer unless there is proof that the employer knew about the unsafe condition causing the accident and did not do anything to fix it. Employers must notify employees of their right to compensation for work-related injuries and diseases. Employees must also be notified that they cannot be fired for filing a claim and that workers' compensation premiums cannot be deducted from their pay. Most employers display a poster in the workplace containing this information.

Coverage Provided. Medical expenses for employees injured on the job should be covered by workers' compensation. If an employee is out of work for more than a few days, a percentage of lost wages may also be covered. Lost wage payments are usually about two-thirds of the employee's income, not to exceed state limits. If an employee is left permanently disabled from a work-related injury, the employee may be eligible for a lump-sum payment or long-term benefits. This depends on whether the employee can perform other work that pays as well as the former position. If a worker cannot earn as much as before the injury, the worker may be eligible for a long-term payment. If the worker is completely and permanently disabled, the worker may be eligible for social security benefits.

Injuries Not Covered. Although laws vary from state to state, generally, the following injuries would not be covered by workers' compensation insurance:

- Injuries individuals afflict on themselves
- Injuries suffered under the influence of alcohol or illegal drugs
- Injuries suffered during a fight that the injured employee started
- Injuries suffered while disobeying orders or violating employer policy
- Injuries suffered while committing a crime
- Injuries suffered while not on the job

Filing A Claim. There are certain steps that must be followed in the event of an injury or illness at the workplace. Be sure that you are familiar with these steps so that you know what you and your employee should do in the event of an accident at your business.

1. The injured employee must notify the employer. The employer must be notified immediately after the accident. Check your state law to determine the time limit that employees have for reporting an accident or illness.
2. The employee must follow doctor's orders. If the employee does not follow the doctor's orders, it could be grounds for denying workers' compensation coverage. The doctor should put any special requirements for the employee in writing. Be sure the employee goes to the doctor that handles the workers' compensation cases for your business.
3. The employee must file the claim. The employer must provide the employee with the proper forms, but it is the employee's responsibility to file the claim.

3-7 Financing Your Business

OBJECTIVES

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

ASSESS YOUR FINANCIAL NEEDS

Determine if you need financial assistance. As you start a business, you will have many decisions to make regarding its financing. Your financial needs will vary depending on the size and type of business you start. If you are starting a very small business, you may be able to provide all the startup money you will need. If your business will be large or require special equipment, you may need to look to others for help raising the startup money.

Before you can approach a lender or investor about financing your business, you will have to prepare some financial documents. To begin, you should estimate your startup costs and create a personal financial statement. Then you will prepare pro forma financial statements of the cash flow statement, income statement, and balance sheet. Financial statements based on projections are known as pro forma financial statements. You will learn more about pro forma financial statements in the next lesson. These items allow potential lenders and investors to determine if your business is viable. They also help lenders decide whether the financing you are requesting is reasonable.

STARTUP COSTS
Walters Electric

Item	Estimated Cost
Equipment and supplies	
Computers (3 @ $1,500)	$ 4,500
Scanner	175
Cash registers (2 @ $1,800)	3,600
Printer	400
Supplies	300
Subtotal	$ 8,975
Furniture and Fixtures	
Desks (4 @ $400)	$ 1,600
Chairs (8 @ $75)	600
Subtotal	$ 2,200
Vehicles	
Delivery truck	$10,000
Automobile	8,000
Subtotal	$18,000
Remodeling	
Drywall replacement	$ 1,000
Electrical work	2,500
Paint	1,000
Carpet	3,000
Subtotal	$ 7,500
Legal and accounting fees	$ 3,000
Total	$39,675

<u>**Startup Costs**</u>

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 and plumbing expenses
- Legal and accounting fees
- Licensing fees

Felicia Walters plans to start a lighting fixture store. To help her determine how much money she will need to borrow, she calculates her startup costs. She must include her estimate of startup costs with the other documents she provides to lenders or investors.

PERSONAL FINANCIAL STATEMENT
Felicia Walters

Assets		**Liabilities**	
Cash	$ 5,000	Car loan	$ 6,900
Checking account	13,500	College loan	4,000
Certificate of Deposit	6,000	Credit cards	1,300
Stock	10,000		
Computer equipment	3,000		
Coin collection	2,500		
Total assets	$ 40,000	Total liabilities	$12,200

Total assets − Total liabilities = **Net worth**
$40,000 − $12,200 = $27,800

<u>**Personal Financial Statement**</u>

In order to determine if you have the resources you need to finance your business, begin by assessing your net worth. Net worth is the difference between what you own, called assets, and what you owe, called liabilities. Net worth is also referred to as equity. To calculate your net worth, you should prepare a personal financial statement. On the left side, list all of your assets with their value. Include cash, investments, and any property.

Total the worth of these items. On the right side, list your liabilities and total the amount that you owe. Then subtract your total liabilities from your total assets to determine your net worth. Felicia Walters prepares a personal financial statement to help her determine whether she is able to finance her new business. She finds that her net worth is $27,800, as shown on the next page. After comparing her startup costs to her net worth, Felicia determines that she will need to seek additional financial resources for her business. Felicia will share her personal financial statement and startup cost estimates with potential lenders and investors when she seeks financing for her business.

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. The formula for debt-to-equity ratio is:

Total Liabilities ÷ Total Equity

A high ratio indicates that a business is mostly financed through debt, while a low ratio indicates that a business is primarily financed through equity. The debt-to-equity ratio can vary among industries, so comparisons of ratios among companies within the same industry should be made. Lenders and investors look at this ratio to assess risk. Lenders usually prefer low debt-to-equity ratios. A high debt-to-equity ratio indicates that a company may not be able to generate enough cash to meet its debt obligations. Thus, a bank runs the risk of not being repaid for its loan. Having the right mix of debt and equity will help ensure your business's sound financial future.

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. Other sources of equity capital include people you know or venture capitalists.

Personal Contributions

Many entrepreneurs use their personal savings to finance the start of their business. Investing personal finances can help you get a loan from a bank. By investing your own money, you demonstrate to the bank that you have faith that your business will succeed. Financing the startup costs entirely by yourself is called bootstrapping.

Friends and Relatives

Friends and relatives can be a good source of equity capital. They will already be familiar with your business idea and know whether you are trustworthy and a good risk. They may be willing to invest more money in your business than other sources in return for a share of the business profits.

Venture Capitalists

Some privately owned companies get financing through venture capitalists. Venture capitalists are individuals or companies that make a living investing in startup companies. They carefully research opportunities that they believe will mal(e above-average profits. They are usually interested in companies that have the potential of earning hundreds of millions of dollars within a few years. The prospect of a company going public by publicly offering shares of stock for sale also attracts venture capitalists. Because of the desired criteria, many small businesses would have trouble attracting the interest of 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

If friends and relatives are not interested in investing in your business with equity capital, they may be willing to loan you money. Before borrowing from friends or relatives, consider how the loan may affect your relationship with them. Those who loan you money might also feel they can give you advice along with their money. You may decide that the risk of losing a friend if you are unable to pay back the borrowed funds is not worth taking. If you take a loan from friends or relatives, you should prepare a formal agreement that spells out the terms of the loan. Be sure both you and the individuals loaning the money understand exactly how much interest and principal you will pay each month. Also, specify what your obligations are to pay back the loan if your business is not successful.

Commercial Bank loans

Most businesses take out loans from banks. Entrepreneurs usually have an established relationship with a bank and begin looking for funds there. When a loan is obtained, it must be repaid with interest in a certain time period. There are different types of loans that banks offer their customers.

Secured Loans. Loans that are backed by collateral are called secured loans. Collateral is property that the borrower forfeits if he or she defaults on the loan. Banks demand collateral so that they have some recourse if the borrower fails to repay the loan. Suppose you take out a $25,000 business loan and use your home as collateral. If you fail to repay the loan, the bank has the right to take ownership of your home and sell it to collect the money you owe. Banks accept different forms of collateral, including real estate, savings accounts, life insurance policies, stocks, and bonds. Types of secured loans include the following:

1. Line of credit An agreement by a bank to lend up to a certain amount of money whenever the borrower needs it is called a line of credit. Banks will charge a fee for this program whether or not money is actually borrowed. In addition, they will charge interest on the borrowed funds. Most businesses establish lines of credit so that funds are readily available to help them make purchases when necessary.
2. Long-term loan A loan payable over a period longer than a year is a long-term loan. Long-term loans are generally made to help a business make improvements that will boost profits. For example, the owner of a small coffee shop may obtain a $50,000, five-year loan to increase the size of the shop to accommodate more customers.
3. Accounts receivable financing Many businesses allow their customers to charge merchandise and services and pay for them later. The balances owed by customers are called the business's accounts receivable. A bank will loan a business up to 85 percent of the total value of its accounts receivable if it feels that the business's customers are good credit risks. As the receivables are paid, the payments are forwarded to the bank. The interest rate for accounts receivable financing is often higher than for other types of loans.
4. Inventory financing When banks use the inventory held by a business as collateral for a loan, it is called inventory financing. Banks usually require that the value of the inventory be at least double the amount of the loan, and the business must have already paid its vendors in full for the inventory. Banks are often not eager to mal(e this kind of loan. If the business defaults, the bank ends up with inventory it may have trouble reselling.

Unsecured Loans. Loans that are not guaranteed with collateral are unsecured loans. These loans are made only to the bank's most creditworthy customers. Unsecured loans are usually made for very specific purposes. They are usually short-term loans that have to be repaid within a year. A business may obtain a short-term loan to help with temporary cash flow problems during slow or seasonal periods. Unsecured lines of credit are also available for those who have good credit.

Reasons A Bank May Not Lend Money. Banks use various guidelines to determine whether borrowers are a good risk. They reject applications that do not meet their criteria. Some of the main reasons banks turn down loan applicants include the following:

1. The business is a startup. Banks are often reluctant to lend money to startup businesses because new businesses have no record of repaying loans. They are more likely to default on their loans than established companies.
2. Lack of a solid business plan. Banks evaluate businesses based on their business plans. A company with a poorly written or poorly conceived business plan will not be able to obtain financing from a bank.
3. Lack of adequate experience. Banks want to be sure that the people setting up or running a business know what they are doing. You will have to show that you are familiar with the industry and have the management experience to run your own business.
4. Lack of confidence in the borrower. Even if your business plan looks solid and you have adequate experience, you may fail to qualify for financing if you make a bad impression on your banker. Make sure you dress and behave professionally. Show up on time for appointments, and provide all information your banker requests.
5. Inadequate investment in the business. Banks are suspicious of entrepreneurs who do not invest their own money in their businesses. You will have to commit a significant amount of your own money if you are to receive financing from a bank.

Obtaining bank financing for a startup business is difficult but not impossible if you can show that you are confident, well prepared, and able to repay the loan. Being aware of banks' most common objections can help you prepare for the application process. For instance, you can properly prepare your business plan, wear a business suit to bank appointments, and arrive on time to make a good impression.

Other Sources of Loans

In addition to commercial banks, there are many government agencies that can assist you with debt capital loans.

- Small Business Administration. Approximately 95 percent of all businesses are eligible for SBA assistance. The SBA aids entrepreneurs most often by guaranteeing loans made by commercial banks. This means if you default on the loan, the SBA will pay a certain percentage of the loan to the bank. This helps banks feel more comfortable about lending money. The SBA also makes funds available to nonprofit organizations that, in turn, make loans to eligible borrowers.
- Small Business Investment Companies. SBICs are licensed by the SBA to make loans to and invest capital with entrepreneurs.
- Minority Enterprise Small Business Investment Companies. MESBICs are special kinds of SBI Cs that lend money to small businesses owned by members of ethnic minorities.
- Department of Housing and Urban Development. HUD provides grants to cities to help improve impoverished areas. Cities use these grants to make loans to private developers who must use the loans to finance projects in needy areas. The American Recovery and Reinvestment Act of 2009 (Recovery Act) includes $13.61 billion for projects and programs administered by the Department of Housing and Urban Development, nearly 75 percent of which was allocated to state and local recipients. Recovery Act investments in HUD programs will generate tens of thousands of jobs and support a broad range of housing and community development projects.
- The Economic Development Administration. The EDA is a division of the U.S. Department of Commerce that partners with
- distressed communities throughout the United States to foster job creation, collaboration, and innovation by lending money to businesses that operate in and benefit economically distressed parts of the country. Borrowing from the EDA is similar to borrowing from the SBA, but the application is more complicated, and the restrictions are tighter.
- State Governments. Government assistance may also be available at the state level. Almost all states have economic development agencies and finance authorities that make or guarantee loans to small businesses.
- Local and Municipal Governments. City, county, or municipal governments sometimes make loans to local businesses. The loans are usually $10,000 or less.

Chapter Summary

- **An existing business has an established customer base and relationships with suppliers. The seller may train you, and prior records can make financial planning easier.**
- **When evaluating a franchise opportunity, study the disclosure document, interview current owners, investigate the franchisor's history, investigate potential earnings claims, compare opportunities, get promises in writing, learn the risks of canceling the franchise' and seek advice from professionals.**
- **Joining a family business has advantages, such as pride in the business and enjoyment of working with relatives. However, family politics can negatively affect the business.**
- **Entrepreneurs who start entirely new businesses are completely independent and create their own destinies. However, there is increased risk because there is no established demand for the product or service and you must make all the decisions.**
- **A sole proprietorship is the easiest form of business ownership, but the owner may have trouble raising money for the business. Personal assets are at risk if the business fails.**
- **A partnership is easy to start, faces little government regulation, and shares the risk with others. But a partner can be held legally liable for the actions of the other partner(s).**
- **A corporation is more difficult to start, but it is easier to raise capital by issuing shares of stock. Owners' personal assets are not at risk.**
- **Antitrust laws were developed to promote fair competition in business. The Antitrust Division of the U.S. Justice Department and the Federal Trade Commission are government agencies that work to ensure fair competition.**
- **Entrepreneurs can protect intellectual property by registering for patents, copyrights, and trademarks.**
- **Laws that protect consumers include licensing, zoning, and consumer protection laws.**
- **Legal issues affecting a business include contracts, torts, and agencies. Lawyers can assist in handling these and other issues.**
- **Options for locating retail businesses include downtown areas, neighborhood shopping centers, community shopping centers, regional shopping centers, super-regional shopping centers, stand-alone stores, and warehouses.**
- **When choosing a location for service businesses that customers visit, the same factors must be considered as for retail businesses. For service businesses where the service is performed on-site, the business location is not as important.**
- **For industrial businesses, availability of good employees and low cost are key factors in choosing a location.**
- **Operating a small business out of the home can save on costs, but it may make it difficult to separate personal and business life.**
- **Starting a virtual or online business allows a startup business to have an immediate presence and compete with larger, established businesses.**
- **Mapping your trade area with possible locations, the locations of competitors, and the locations of businesses that draw the same target customers can help you narrow your location options.**
- **To evaluate leases, compare the costs and expected benefits of various locations and the types of leases - gross, net, or percentage - offered. Calculating the rent per customer can help you determine which location is most cost-effective.**

- **The layout of a business depends on the type of business. For retail businesses, the aim of a layout is to attract and keep customers. For wholesale businesses, the aim of a layout is to store inventory in the most efficient manner. For manufacturing businesses' the aim of a layout is to facilitate the production process.**
- **Once you determine your equipment and supply needs, you will need to identify and evaluate a number of vendors by obtaining quotes.**
- **To determine the amount of inventory to keep in stock and the reorder point, consider the amount of expected sales, the time it takes your supplier to get merchandise to you, and how important it is for you not to be out of stock for the item.**
- **To determine staffing needs, list all the duties in your business, identify how much time is needed to perform each one, determine the skills and qualifications employees need, and write job descriptions that list the specific responsibilities of each position. You should also create an organizational structure to show the relationships between the various jobs in the company.**
- **To recruit new employees, you may use online career and employment sites, employment agencies, college placement centers, in-store advertising, classified advertisements, and referrals.**
- **In addition to hiring permanent employees, you can also hire freelancers, interns, or temporary workers.**
- **The four steps in the hiring process include (1) screen candidates, (2) review and verify information on job applications, (3) interview the best candidates, and (4) make a job offer.**
- **A compensation package should include a method of pay and may provide a variety of benefits. Types of pay include wages, salary, commission only, or a combination of salary plus commission. Bonuses and profit sharing are other compensation methods. Benefits may include paid leave for vacation and sickness; medical, dental, life, and accident and disability insurance; and retirement plans.**
- **Employers must follow all laws and regulations that are created to protect employees from unfair labor practices.**
- **To prepare for risks, you should (1) determine what can go wrong, (2) develop a plan, and (3) communicate your plan to**
- **employees and first responders.**
- **Theft is one of the biggest risks faced by business owners. Types of theft include shoplifting, employee theft, robbery, credit card fraud, and bounced checks. Business owners can take precautions to prevent these risks.**
- **Classifications of risk faced by businesses are based on the result of the risk (pure or speculative), controllability of the risk (controllable or uncontrollable), and the insurability of the risk (insurable or uninsurable).**
- **Insurance does not cover risks that cannot be reasonably predicted or risks in which the financial loss cannot be calculated. These risks are tied to economic conditions, consumer demand, competitors' actions, technology changes, local factors, and business operations.**
- **You will have to analyze the risks your business faces to determine the types of insurance you should purchase. A typical business owner's policy (BOP) covers property damage, business interruption, and liability. Depending on your situation, you may also want to purchase life, flood, crime, or renter's insurance.**
- **Before committing to an insurance purchase, compare prices and policies and seek advice from experienced business owners.**
- **Although useful to you as a business owner and to your customers' credit has risks associated with its use. You must analyze the potential risks of credit to determine if it is wise for you to use and/or extend it.**
- **Workers' compensation insurance covers employees' medical expenses and lost wages incurred as a result of workplace injuries and occupational illnesses.**