

Preparing Your Business Plan

By Linda J. Cox

Every business venture can benefit from the preparation of a written business plan. The business plan can:

- Help you think through the business by considering all of your options and identifying any potential difficulties
- Convince potential lenders and investors to put money into your business
- Serve as an operating guide as you turn your ideas into a viable business

It's easy to get started—just get out a pencil and paper, and carefully work through the outline, answering all of the relevant questions. There is also computer software available to help guide you through this process. You'll feel much more confident and in control once it is over, so get started today!

Business Plan Outline

Cover Sheet

What are the following?

- Business name
- Address
- Phone number
- Names and addresses of the principal owners
- Date of the plan

Have you made your plan professional and easy to update by typing it on high quality paper and putting it in a loose leaf binder?

Executive Summary

What are the important points of your business? (summarized in one or two pages) Will this plan be used as an operating guide or a financial proposal?

For an operating guide:

- Are you explaining all important functions?
- Have you inadvertently disclosed any trade secrets?

For a financial proposal:

- Who is requesting the funds and how much is needed?
- What will the money be needed for?
- How will the funds be repaid?
- What collateral will be offered to secure the loan?
- Why does a loan or an investment make sense?

Table of Contents

Have you listed page references for all major topics?

Description of Business

What business are you in?

- What is the nature of the product(s) or service(s)?
- What will be special about your business?
- Do the seasons affect your sales?

What is the history of your business?

- If the business is going downhill, why?
- How can you turn it around?

Where is the business located and what are the facilities like?

- Does the business own or lease any land or buildings?

- What are the terms and length of the lease?
- How will your business affect your neighbors and community?
- How much can your business grow before you will be forced to move or expand?

Do you have the necessary licenses and permits?

- Is your business name registered?
- Have you considered local zoning regulations?

How will your management make the business more profitable?

- What changes do you plan to make in the business?

Does your business have sufficient insurance?

- What are your potential business risks?
- What insurance coverage will you purchase to protect yourself?

Production

What is the production process?

- How much of each input is physically required to complete each step in the process?
- What is the cost of each input?
- Which inputs are most expensive?
- Is there any way to use less of any input, especially the expensive ones, without affecting quality?
- Are any inputs potential sources of problems now or in the future?
- What is the cost of production, including total variable and overhead cost per unit, assuming everything that is produced sells?

What is the potential production schedule, monthly, for two years?

How will you become aware of the latest technology?

What kind of production information system will you need?

See Calculating Your Cost of Production

Marketing

Who are your customers?

- What are your consumers' needs does your product fill?
- What is the age, sex, occupation, life-style, income, etc., of your potential customers?

What is the present size and growth potential of the market?

What percent of the market will you have now and in the future?

What is your competition?

- What products meet the same consumer needs as yours?
- What are the strengths and weaknesses in the marketing strategy of each competitor?
- How will you market your product your product so that people will buy your product?

What is your strategy for attracting and keeping your customers?

- How will your product, including packaging your customer's needs?
- How will you price your product?
- How will you promote your business and your product?
- What market places will your product move through as it goes to the final customer?

How many will you sell at what price every month for the next twenty four months?

See Putting Together a Marketing Strategy

Finance

What is your financial situation?

- Current balance sheet
- Cash flow budget
 - Detail by month, first year

- Detail by quarter, second year
- Notes of explanation and assumptions
- Projected income, statement
 - Detail by month, first year
 - Detail by quarter, second year
 - Notes of explanation and assumptions
- Projected balance sheet, two years
 - Notes of explanation and assumptions
- Break-even analysis
- Relevant financial analysis, three years past and two years future

See Managing Your Finances

Management and personnel

What is your business and management experience (in general and in this type of business)?

What technical and business education have you had, including both formal and informal?

What is your organizational structure?

What other management resources will be available (accountant, lawyer, banker)?

What are your anticipated personnel needs?

- What skills must your employees have?
- What are the job description, pay range, and evaluation plan for each position?
- Will you have to train people? What will the training program be and how much will it cost?

Supporting Information

What additional documents could help you understand your business?

- Balance sheets, past three years
- Income statements and/or tax returns, past three years
- Personal resumes for all principals
- Current balance sheet of all principals and past three years personal income tax returns of all principals
- Letters of reference
- Letters of intent from customers
- Copies of all leases, contracts, agreements, deeds, licenses, permits, or other legal documents
- Any other information that might help your cause or answer potential questions

The Bottom Line

After your plan is finished, don't let it collect dust. It's easy to get wrapped up in day to day operations, but try to revisit your plan regularly to make sure your business is still headed in the right direction. And, as time passes and the world changes, update your plan so your business is still looking to the future.

Calculating Your Cost of Production

Knowing your cost of production is very important because it helps you calculate the minimum price that you can accept for your product without losing money. At the same time, some producers assume that the actual amount that they receive for their product should be based on their cost of production, but this is not the case. The price that you receive for your product is not based on your cost of production, but rather it is determined by the marketplace and what consumers are willing to pay for it, i.e., how much they value it. The prices that you receive from a buyer (or middleman) reflects the retail price minus the costs for their services.

The market used by you and other producers probably has many sellers and a few big wholesale buyers. The sellers are competing against each other, so the buyers have their pick of whose goods to buy. In this type of market, the seller's cost of production is likely to be almost equal to what buyers are willing to pay. If you are one seller with many buyers, you may have the power to set your price higher than your cost of production. But sellers with a large market share should always expect other sellers to try to break into the market.

Because it isn't so easy to maintain a large market share, many sellers face markets in which price will be nearly equal to their cost of production, including expected profits. Therefore, you need to compare the price that you are offered to the total cost of producing your product in order to make sure that you will cover your production costs. If your costs are covered by the amount that you are offered, then you and your business are heading in the right direction. However, if your costs are not being covered by the price of your product, then you need to consider making some changes in your business. The steps for calculating your cost of production are given here.

Identifying Your Costs

Ideally, identifying your costs, calculating your cost of production, and product pricing should take place on paper before you get into business. However, even if your business is in full swing, you can use this cost information, so it's never too late.

To figure out your cost of production, you have to collect information and calculate how much it costs to plant, grow, harvest, catch, process, market, and deliver your product. You can get some of this information from your company's past income statements. If you don't have these figures at your fingertips, you can gather information from income statements of similar businesses within an industry, or by reading about an industry at the library, or by asking in the business, or doing small experiments.

Common types of production, processing, and retail costs are found in the table below. Once they are collected, these costs can be divided into two categories: variable cost per unit and overhead/fixed costs. However, some expenses may fall into both categories, depending on your industry and company. You may have to put part in one category and the remainder in the other.

Operating/Variable Cost Per Unit

Operating cost, or variable cost, per unit includes all costs that are directly related to each unit produced. For example, you need to have a system for calculating the cost of all the feed, seed, labor, fertilizer, insecticide, packing materials, some equipment and so forth that you use to produce or process each flower, vegetable, fruit, chicken, or fish.

As you identify the category that each cost belongs in, you will want to think about which portion of the expenses can be tied to the production and sale of a product. In the case of the phone bill, for example, only your long distance charges may be variable because they depend on how much you can produce and sell. Your monthly charge is always the same, and that cost should not be considered an operating/variable cost.

Overhead Costs/Fixed Costs

Overhead costs (see Table 1), or fixed costs, represent all business expenses that you have not included in your variable costs because overhead costs do not change when output increases or decreases (e.g., even if you are not producing, you still need to cover the cost of rent).

Two of the biggest overhead/fixed costs, which are often overlooked, are the cost of using your money to finance your business and the cost of the owner's labor and management skills. These two costs are paid from the profits that you expect the business to earn for you. Ideally, you want to earn enough to pay a return on the money that you have invested in the business, and you want to earn enough to pay you for all of the time that you put into the business. The business will not automatically do this unless you recognize these as costs and get a plan to pay your expected profits.

Estimating the "Cost" of Using Your Money and Time

To estimate the "cost" of using your money for your businesses, first calculate how much you have invested in your business, then decide on your desired return rate. To help you decide, examine alternative investments, or the opportunity cost of your capital (money). For example, if you invest in the stock market, over a twenty-year period you can expect to earn about a 13.5 percent average annual return, but there is no guarantee. Alternatively, the interest on a savings account is smaller, but you can be sure that you will earn the interest promised to you. In determining the "cost" of using your money, you should remember that the higher the average desired return, the greater the risk of getting less than the average during the given year.

You also need to know how much time is spent running the business (time that is not already counted in the cost of producing and marketing a specific product), so that you account for the money you want to earn for running your

business. You should multiply the number of hours that you worked times your desired wage rate to estimate the cost of running your business. In setting a wage rate, you might think about what it would cost your business to hire someone else to do the work for you.

Calculating Your Cost of Production

Once you know your annual variable and overhead/fixed costs, you can add them up and get your total business costs. If you divide total business costs by the number of units that you make and sell in a given time period—your current production output—then you can get the break-even price for one unit. That unit cost can be compared with the price you are offered or can get in the marketplace.

The break-even price is your product's minimum selling price. The actual selling price of your product must be equal to or larger than the break-even price of the product or losses will occur. In order to estimate your actual selling price, you need information on the prices in the market in which you will be selling. If you know the selling price of each unit, then the minimum number of units that you must sell to pay expenses, or the break-even quantity, can be calculated.

The break-even quantity tells you how many units you have to sell to pay expenses. The break-even quantity may be less than the maximum quantity that you can produce, but if the break-even quantity is more than your maximum, you will not be able to cover all of your costs because you can't produce and sell enough. Remember that your expected profits have been included as part of your total business costs, so your actual selling price or actual number of units sold will not need to be much greater than the break-even estimate.

Value in the Marketplace

While your break-even price tells you what you must receive to cover all of your costs (i.e., minimum selling price) it does not mean that the price must be the sales price of your product. Your selling price is also determined by your customers and your competition.

Some consumers may not be willing to pay as much as others. You can give special discounts to consumers that are more sensitive to price by lowering your prices during certain days of the week or months of the year, for certain customers, or for a certain volume of purchases. For example, Kamaaina rates, Mele Kalikimaka airplane fares, and buy two, get the third free offers are all ways to attract customers that might not buy otherwise.

At the same time, you might want to offer a lower price to one big buyer than you would offer many small buyers because it really is cheaper to sell to one rather than many buyers. Some businesses also sell products that complement each other or sell products as a group in order to make large sales. For example, flower stores often sell balloons or stuffed animals and give small price discounts if these items are purchased as part of a flower arrangement. Supermarkets often sell a few products at or below cost, just to bring in consumers who will also buy other, more profitable products.

Sometimes, you may need to sell some products at a price lower than break-even just to keep your market share or to get through an unexpected increase in supply or decrease in demand. Then, you can make up for the short-term loss later when market conditions are better. For example, demand for fluid milk in Hawaii usually decreases in the summer. A dairy producer would generally plan to produce less in the summer, but would probably sell any excess at a lower price to an ice cream processor, rather than dump the milk.

The prices of your competition are also important in your pricing decision because you can always buy someone else's product. You will need to decide whether your product is different enough to get a higher price. If your product is fresher or tastier, consumers may be willing to pay more for it. For example, Kona coffee can only be grown in Kona and this makes it unique. As a result, Kona coffee is sold at premium prices. Ultimately, the consumer decides what they are willing to pay, but if your product is unique you may have more control of the price of your product.

Business Options

If you find yourself in a situation where you will be losing money or you are not satisfied with your selling price, you have four choices. You can:

- Lower your cost of production
- Change the quality of your product, so you can get a higher price

- Lower your expected profits
- Get into another form of business

Remember that your product's actual selling price reflects what customers think it is worth to them. Customers don't know, and probably don't care, about your cost of production. It is up to you to prepare for any unexpected expense. The more information and experience you have, the better prepared you will be to price your product profitably.

GROSS REVENUE, Σ :	Quantity/acre	In units of	@ \$/unit =	Gross revenue/crop =		% of gross revenue
1992 TYPICAL yield & price	23,000	Pounds	\$0.431	¢ per pound	\$ per acre	
				43.1	\$9,913	100.0%
OPERATING COSTS, Δ (by activity):	Quantity/acre	In units of	@ \$/unit =	Operating costs / crop =		% of gross
<u>A. Pre-harvest costs:</u>	Note: Pre-harvest labor/hr.		\$10.00	¢ per lb.	\$ per ac.	
1 Land Preparation =				3.7	\$849.20	8.6%
A Labor to clear patch	28.30	Hours	\$10.00	1.2	283.00	2.9%
B Fertilizer: Lime, if necessary	0.00	Bags	\$13.00	0.0	0.00	0.0%
C Labor to machine till	4.36	Hours	\$10.00	0.2	43.30	0.4%
D Labor to machine rough level	4.36	Hours	\$10.00	0.2	43.60	0.4%
E Machinery operating costs	8.70	Hours	\$30.00	1.1	261.00	2.6%
F Custom rototilling	0.00	Hours	\$95.00	0.0	0.00	0.00%
G Labor to hand level	21.80	Hours	\$10.00	0.9	218.00	2.2%
2 Planting (given spacing) = 27	16	Inches		1.3	\$305.00	3.1%
A Seed (huli) @ sq. ft./plant of 2.8	15,488	Huli	\$0.00	0.0	0.00	0.0%
B Labor to raise & plant seedlings	30.50	Hours	\$10.00	1.3	305.00	3.1%
3 Fertilization =				3.7	\$850.45	8.6%
A Fertilizer: 15-15-15	22.00	Bags	\$14.80	1.4	325.60	3.3%
B Fertilizer: Super Phosphate	1.30	Bags	\$ 0.94	0.0	1.22	0.0%
C Fertilizer: Muriate of Potash	26.10	Bags	\$11.71	1.3	305.63	3.1%
D Labor to apply fertilizers	21.80	Hours	\$10.00	0.9	218.00	2.2%
E Mechanized Operations	0.00	Hours	\$20.00	0.0	0.00	0.0%
4 Pest Control =				13.2	\$3,035.45	30.6%
A Herbicide: Round-up	0.57	Gallons	\$85.00	0.2	\$48.45	0.5%
B Labor to spray herbicide	39.20	Hours	\$10.00	1.7	392.00	4.0%
C Labor to hand weed	240.00	Hours	\$10.00	10.4	2,400.00	24.2%
D Labor to machine mow	6.50	Hours	\$10.00	0.3	65.00	0.7%
E Fungicide: Ridomil	0.00	Pounds	\$14.39	0.0	0.00	0.0%
F Other pest control expense	0.00	Pounds	\$0.00	0.0	0.00	0.0%
G Other pest control expense	0.00	Pounds	\$0.00	0.0	0.00	0.0%
H Labor to apply other pesticides	0.00	Hours	\$10.00	0.0	0.00	0.0%
I Mechanized Operations	6.50	Hours	\$20.00	0.6	130.00	1.3%
5 Irrigation =				0.5	\$120.00	1.2%
A Water	0.00	Acre inches	\$0.00	0.0	0.00	0.0%
B Labor to apply water & maintain system	12.00	Hours	\$10.00	0.5	120.00	1.2%
6 Operating interest @ APR 10.0 %	6.67%	Per crop on	\$5,160	1.5	\$344.01	3.5%
A. Total pre-harvest cost =				23.9	\$5,540.11	55.5%
<u>B. Harvest Costs:</u>	Note: Harvest labor/hr. =		\$8.00			
1 Harvesting, grading, & packing =				7.9	\$1,827.95	18.4%
A Labor, w/huli @ bags/hr. = 1	193.60	Hours	\$8.00	6.7	1,548.80	15.6%
B Labor, w/o huli @ bags/hr. = 3	31.30	Hours	\$8.00	1.1	250.40	2.5%
C Bags, @ 80 lbs./bag =	288	Bags	\$0.10	0.1	28.75	0.3%
D Mechanized Operations	0.00	Hours	\$10.00	0.0	0.00	0.0%
2 Shipping =				0.8	\$175.57	1.8%
A Labor to transport to market/ shipping pt.	7.00	Hours	\$8.00	0.2	56.00	0.6%
B Mechanized Operations	7.00	Hours	\$10.00	0.3	70.00	0.7%
C Commissions & excise tax	0.50%	Of gross revenue		0.2	49.57	0.5%
D Freight, storage & other shipping costs	0.00		\$0.00	0.0	0.00	0.0%
B. Total harvest cost =				8.7	\$2,003.5	20.2%
TOTAL OPERATING COSTS OF PRODUCTION, Δ (A + B) =				32.6	\$7,508	75.7%
GROSS MARGIN (Gross revenue minus operating costs, $\Sigma - \Delta$) =				10.5	\$2,405	24.3%

Source: Fleming, Kent. 1994 The Economics of Commercial Wetland Taro Production in Hawaii. CTAHR, AgriBusiness No.7

If you want your business to be profitable, your cost of production is important because it determines your minimum selling price. Forms 1 to 11 have been designed to help you calculate your cost of production.

Form 1, Pricing the Production Process I, determines the cost of materials, labor, and equipment for each step of the production process.

Form 2, Pricing the Production Process II, identifies the total cost of the production process. When you divide the total cost of production by the number of units you produced, you will know the total cost of the production per unit. This is often referred to by business professionals as the “variable cost per unit.” Variable cost per unit accounts for all costs associated with producing one unit.

However, there are other expenses you have that cannot be directly tied to the production of one item. These are called overhead costs. They include marketing, management, and product development expenses. Overhead costs represent expenses that you have not already included in the cost of production. Form 3, Overhead Costs, estimates your overhead costs.

One type of overhead cost that you need to estimate is your desired profits. First calculate how much you have invested in your business. After completing the Finance section, you will have this number. Then, decide on your desired return rate. To help you decide, examine alternative investments. For example, if you invest in the stock market, over a twenty year period you can expect to earn about a 13.5 percent return rate. Alternatively, a savings account gives a lower rate of return.

The labor of the owner is one of the biggest overhead costs of a small business. Form 4, Schedule for an Average Week, will help you determine how much time you are spending in your business on each type of business related activity.

If you expect your business to pay for all your time and all the time of others who work in the business, you need to estimate how much all the unpaid labor used by your business costs. Form 5 and 6, Cost of Your “Unpaid” Labor and Cost of Others’ “Unpaid” Labor, determines these costs. Review the activities you have described in the production process to be sure that all time is accounted for. Marketing includes all the time spent developing promotional materials, distribution, selling and other promotional activities. Management includes time spent keeping the books, doing taxes, obtaining permits, and other administrative work. Product development involves time spent in professional improvement, test marketing, market research, and other such activities.

You are now ready to complete Form 7, Total Production Costs, to determine total cost of production per unit. Remember that your selling price cannot be lower than your cost per unit or you will be losing money. If this selling price is too high, then you cannot be paid for all your labor and/or you need to reduce other costs.

Form 1 Pricing the Production Process I

Description of the Activity

Material Costs

	Quantity	X	Price	=	Total Cost
1	_____	X	_____	=	_____
2	_____	X	_____	=	_____
3	_____	X	_____	=	_____
4	_____	X	_____	=	_____
5	_____	X	_____	=	_____
6	_____	X	_____	=	_____

Total Materials Cost _____

Labor Cost

	Hours	X	Wage Rate	=	Total Cost
1	_____	X	_____	=	_____
2	_____	X	_____	=	_____

Total Labor Cost _____

Equipment Cost

	Hours	X	Cost Per Hour	=	Total Cost
1	_____	X	_____	=	_____
2	_____	X	_____	=	_____
3	_____	X	_____	=	_____
4	_____	X	_____	=	_____

Total Equipment Cost _____

Total Cost of Activity _____

Form 3 Overhead Costs

Item	Estimated Costs
Rent	
Medical Insurance	
Pension Plans for Employees	
Advertising	
Transportation	
Printing	
Professional Memberships	
Professional Development	
Liability Insurance	
Paid Labor (other than those included in the production process)	
Unpaid Labor (total unpaid – unpaid production labor)	
Utilities	
Shipping	
Material/Supplies (other than those included in the production process)	
Desired Profits= Total Investment in the Business x Desired Return Rate	
Total	

Form 4 Weekly Time Sheet

Use an "X" to indicate the hours you will be working on an average week. Then check to see how this fits your normal schedule.

	SUN	MON	TUE	WED	THU	FRI	SAT	SUN	
MIDNIGHT									
1:00									
2:00									
3:00									
4:00									
5:00									
6:00									
7:00									
8:00									
9:00									
10:00									
11:00									
NOON									
1:00									
2:00									
3:00									
4:00									
5:00									
6:00									
7:00									
8:00									
9:00									
10:00									
11:00									
TOTALS									
	DAILY								WEEK

Form 5 Cost of Your "Unpaid" Labor

Record the hours worked by you over the course of the year. Do not include labor used in the Production process. All "Unpaid" Production labor should be included on forms 4, 5, 6.

Hours worked by you per month

ACTIVITY	JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG	SEP	OCT	NOV	DEC	ANNUAL TOTAL
Product Development													
Marketing													
Management													
TOTAL HOURS													

A) Total hours worked by **you** in one year _____

B) Hourly cost of **your** time _____

C) Any amount paid or withdrawn _____

Cost of your "unpaid" labor = (A x B) – C _____

Form 6 Cost of Others "Unpaid" Labor

Record the hours worked by others who were not paid employees over the course of the year. Do not include labor used in the Production process. All "Unpaid" Production labor should be included on forms 4, 5, 6.

Hours worked by you per month

ACTIVITY	JAN	FEB	MAR	APR	MAY	JUNE	JULY	AUG	SEP	OCT	NOV	DEC	ANNUAL TOTAL
Product Development													
Marketing													
Management													
TOTAL HOURS													

A) Total hours worked by others in one year _____

B) Hourly cost of their time _____

C) Any amount paid or withdrawn _____

Cost of your "unpaid" labor = (A x B) – C _____

Form 7 Pricing the Production Process II

Total Production Cost

Overhead Costs Per Unit = Total Overhead Costs/Number of Units Produced in a Year

Overhead Costs Per Unit \$ _____

+

Variable Cost Per Unit \$ _____

Total Production Cost Per Unit \$ _____

Selling price should not be less than total production cost per unit or you will lose money.

Putting Together a Marketing Strategy

A market is made up of buyers and sellers, both bringing different perspectives to the marketplace. In marketing your product, you must remember that it is much easier to sell something that people want or value, at a price *they* are willing to pay, rather than trying to convince them to buy something that you produce at the price you want to charge.

Your Customers

You may or may not be directly selling to those people that actually use your product. There may be others, often called middlemen, who handle your product as it moves from you to the final customer. The pathway that your product follows to get to the final customer is called your marketing channel.

Each middleman provides services to their customers and is paid for those services by selling your product at a higher price than they pay for it. You may or may not want to use middlemen, but you must remember that your final customers want the services that the middleman provides. At the same time, the middleman controls which products go to the final consumer and is, therefore, also one of your customers. In order to make the most of your situation, you should stay informed about what influences the buying and selling decisions of the middlemen that handle your product. In the long run, keeping informed will help you sell your product to additional middlemen in your marketing channel. Then, you can make price comparisons and be more aware about the industry. For instance, you can be a regular user of the Hawaii Department of Agriculture's Market News Service 24-hour Wholesale Market Hotline, Tel: (808) 973-9581.

You must also know your final customers. You should construct a profile of your final customer, which includes information about their age, gender, race, income, family status, values, cultural associations, spending patterns, and shopping habits. Although you have many different customers, try to group them using their similar characteristics. This will help you understand who buys your product, so you can direct your product into the correct marketing channel and focus your marketing efforts.

Market Research Basics

Anytime you start to answer questions about your customers, your competition, and your marketing strategy, you are doing market research. Getting a list of specific questions that you need answers to is a good beginning. Then, you do research by collecting data and analyzing it in order to answer all of your questions. Your research data will come from either primary or secondary sources.

You can get primary data from current or potential customers, employees, suppliers, or anyone else involved in your business. You can get this data using a survey, holding a group discussion, or by talking to people individually. Primary data is costly because it takes time and/or money to ask specific questions about your business.

Secondary data may be less expensive than primary data because it already exists. It comes from sources like government reports and trade publications, which will not give you information specifically about your business, but it may still be useful. A library is a good place to start looking for secondary data.

There are two types of primary or secondary data: quantitative and qualitative. Quantitative data is expressed as numbers that tell you who your customers are and what they are doing. Demographic data that describe people, like age, gender, income, and education are the most common type of quantitative data used in marketing research.

Qualitative data is about people's feeling and perceptions and cannot be turned into numbers. While quantitative data cannot be put into a table or chart, it does help you understand what motivates your customers. Psychographics, the most common form of qualitative data, describe what groups care about, what they value, and how they live.

The most effective marketing strategies first identify the demographic groups that are most likely to buy your product, and then, use psychographics to reach them. After all, to sell any product, you want to know why and how people decide to buy it.

Your Competition

The first step in evaluating your competition is to determine which competitive products are available to your customers that meet the same needs as your product. You need to determine all of the strengths and weaknesses of these products by examining everything about them including their characteristics, price, distribution system, and media/advertising.

Then, compare your product to the competitor's. These comparisons will help you identify your product's unique qualities. The advantages can be capitalized upon, and the disadvantages can be corrected or avoided. It is vital to the success of your business to be continually "shopping the competition" by comparing your product to the competition's product.

Your Marketing Strategy

You need to develop a company image and message that will convince your customers that your company and your product can best meet their needs. Your marketing strategy should be based on what your market research told you about your customers and your competition. Your marketing strategy should address four major areas:

Product

Your product needs to meet your customer's needs. If your customers want high quality, then your product should meet this need. At the same time, you may need to distinguish your products or services from the competition's. The development of new products or services keeps customers interested in a company and nurtures the ongoing success of the business.

Price

You should choose a pricing strategy that suits your company objectives and the quality of the merchandise and service. In many cases, you may not have any control over how much you can charge for your product. If you sell your products to a middleman, you may be *quoted* a price. If you sell directly to your final customers, you may be able to *set* the price you would like to charge. But remember that your customers may not be willing to buy all that you have to sell if your prices are too high.

Place (Distribution)

The marketplace in which your products are sold affect your sales volume, the final selling price of your product, and your product image. You need to be sure that your product ends up in places where your customers shop.

Promotion

Your promotional strategy should be determined by whom you want to reach and how you want to reach them. You should think of a specific message that you want to tell your customers. Then, look for the most efficient way to get this message out.

Promotion can take many different forms, such as word of mouth, print, radio, or television. Word of mouth is the most effective and most inexpensive but the hardest to generate and control. Therefore, whenever you, your employees, or your product come into contact with the public your message should be clear.

An Example

In order for you to see how relatively straightforward market plan development can be, look at the example in Figure 1 of *kulolo* (a pudding or fudge-like product made from taro) for NoKaOi Poi, a fictitious company. With a lot of soul searching, some careful research, and some customer interviewing, they came up with a plan which will act as a guidepost for their product development and marketing.

NoKaOi Candy of Hawaii's Kings *Kulolo* Products—Condensed Marketing Plan

1. The Product

- Traditional *kulolo* made of taro, coconut cream, and sugar.
- Innovate by adding macadamia chunks and mixed dried Hawaii fruit to develop a three-product *kulolo* line.

2. The Customer

- 15-70 years old
- \$ 15K to \$80K annual household income
- Has contact or had contact with Hawaii
- Likes fudge-like products

3. The Competition

- Chocolate-covered macadamia candy
- Fresh made brownies and cookies
- Mackinaw fudge
- Other *kulolo* products

4. The Marketing Strategy: The 4 P's

Price

- Calculate cost of production to determine minimum selling price
- Establish price lists based on potential sales outlets and volume

Place

- Sell to Hawaii hotels
- Sell at festivals, craft fairs
- Sell at Las Vegas hotels
- Sell to airport stores
- Sell to local stores

Promotion

- Give free samples to media (w/company info)
- Advertise in Office of Hawaiian Affairs newspaper
- Give tours of factory to clubs and other groups
- Custom pack for fund raisers
- Work with hotel chefs to include in picnic baskets
- Advertise in mainland "Voices of Hawaii" newspaper
- Combine with other company's gift packs

Product

- Innovative packing: plastic-wrapped 8 oz packages, and nostalgic 2 lb miniature Hilo-style cracker cans
- Caffeine and chocolate free
- Fun food
- Can be sectioned and distributed easily
- High-energy product
- Product packaging designs traditional, yet contemporary
- Evokes nostalgic feelings
- A traditional and tasty Hawaii product

The Bottom Line

The key to marketing is keeping an eye on your customers—what they need and what they are buying. What may work for one product or company may not work for another. The profitable business is the one that is observant, proactive, and innovative.

Managing Your Finances

You need an organized system to help you manage your finances, so you can get the information that you need to make better decisions. If you have a computer, there are some excellent software programs available to help you with your financial management and they are worth the price.

Financial Statements

The first step in the financial management process is to collect the information to go into a balance sheet, income statement, and a cash flow budget. Then, you can analyze these three financial statements using ratio analysis to determine the financial health of your business.

Balance Sheet

A balance sheet shows your firm's financial position at a specific point in time and reflects the following basic accounting relationship: $\text{Assets} = \text{Liabilities} + \text{Net worth (Owner equity)}$

Assets: Resources or items of monetary value that are controlled by the business. Assets are listed in order of their liquidity, i.e. when they will be used up.

Current assets, listed first will be converted to cash or consumed during the upcoming year. Intermediate assets come second and provide services to the business over time but they are used up (depreciated) or sold (liquidated) within two to ten years. Long-term or fixed assets are last and are those items which normally do not wear out or are not intended for sale within the next ten years.

Liabilities: Debts owed by the business. Liabilities are listed on the balance sheet in order of when they will come due.

Current liabilities, listed first, will be due during the upcoming year. Intermediate liabilities, come second and are debt obligations due within two to ten years. Finally, long-term or fixed liabilities are those debts due in more than ten years.

Net worth, or owner's equity: The current value of the owner's investment in the business. This figure will include investments by the owner in the business and profits that have been retained in the business rather than withdrawn by the owner.

Income Statement

An income statement summarizes the revenues and expenses of your business during a specified period of time, generally a year. Many businesses use the profit-and-loss statement from their income tax form as their income statement.

Cash Flow Budget

A cash flow budget estimates all the cash coming in and going out of your business over a year. To make these forecasts you must anticipate all of the following cash flows each month:

Cash in

- Cash sales
- Payment for credit sales
- New loans
- Owner's investment
- Asset sales

Cash out

- Operating expenses
- Interest and tax payment
- Loan payment
- Owner's withdrawal
- Assets purchases

After it is completed, the budget can be used to project the firm's balance sheet and income statement in the future. You might want to anticipate what you will do if sales aren't as high as you expect or if an unplanned expense occurs, so you are prepared for cash flow problems that might occur.

Financial Analyses

There are two types of financial analyses commonly used by a financial expert. These are break-even analysis and ratio analysis.

Break-even analysis

Break-even analysis estimates the minimum number of units that a firm must sell, or the minimum selling price that the firm must receive, in order to pay all of its expenses. Knowing the number of units that you must sell to pay your expenses, or your minimum sales price, is useful because it is a goal you can shoot for. However, there are other financial goals that are important, and ratio analysis allows you to look at them.

Ratio Analysis

Ratio analysis uses information from your balance sheet and income statement to compute ratios that describe your financial position.

You can analyze your current performance using a current balance sheet and income statement. Or, look into your future by using your projected balance sheet and income statement.

Applied Ratio Analysis

There are four financial goals that are important to your business. Ratios can be used to determine where your business stands in each of these areas.

Liquidity: The ability of a business to pay bills and debts as they become due over the next year.

The most widely used liquidity indicators are the cash flow budget and the current ratio. Since the cash flow budget is done a year in advance, any cash shortage can be anticipated. $\text{Current ratio} = \text{current assets} / \text{current liabilities}$.

A low current ratio, say 1:1, means your business is barely liquid and you may not be able to pay your debts when they become due this year. A high current ratio of 3:1 means that your business is very liquid. This may reduce your business's profitability because current assets generally earn less than intermediate and long-term assets.

Solvency: The ability of a business to pay off all debts over the life of the business.

The most common solvency measure is the leverage ratio. $\text{Leverage ratio} = \text{Total liabilities} / \text{Net worth or owner's equity}$

If your leverage ratio is large, say 2:1, your business has a large amount of debt and could go bankrupt quickly. On the other hand, 1:5, a small leverage ratio, means that your risk of bankruptcy is much smaller, but your opportunities to grow and make profits are also smaller.

Profitability: The ability of the business to earn profits.

Two common measures of profitability are Return On Assets (ROA) and Return On Equity (ROE). In calculating ROE, the figure subtracted from unpaid labor will depend on how much you think this labor is worth. Generally, you should think in terms of how much it would cost to hire someone to do the work that you or a family member currently does. $\text{Return on assets} = \text{net income} + \text{interest paid} - \text{total unpaid labor} / \text{total assets}$

ROA indicates the before-tax rate of return earned by the assets of the business. The interest paid on debts is added back in before ROA is calculated. The ROA of a business must be greater than the interest rate on borrowing or the assets are not earning enough pay for themselves. $\text{Return on equity} = \text{net income} - \text{total unpaid labor} / \text{total net worth}$.

Remember that the ROE tells you how much your business is earning on the money you have invested in it. Looking at the returns you could get from other investments will help you decide if your ROE is acceptable.

Financial Efficiency: The value of inputs as compared to the value of the outputs they produced. Operating expenses ratio = $\frac{\text{total expenses} - \text{interest paid} - \text{depreciation}}{\text{sales}}$.

Various efficiency ratios calculated with data from your income statement determine how much of each sales dollar is paid out for expenses or remains as profit. If large expenses such as labor go up without sales increasing at the same time, then you will know that your business is less efficient.

Things to Remember When Using Ratio Analysis

- Examine the ratios computed from data contained in your firm's financial statement to determine if this value is consistent with your goals. For example, if you want to pursue a goal of high profitability, you may want to be sure your Current Ratio is not high.
- Compare your business with other similar businesses in the industry. Get information at the library, from trade magazines, and from lenders.
- Do not use only one ratio for decision making. Moving toward one goal may result in movement away from another. For example, a movement toward profitability might be a movement away from high liquidity.

Analyze your ratios over time and make decisions on the trends, rather than on one year's performance. Make a chart and see how things change over time. Be sure that you have your business' financial data at your fingertips, and check it often. You can congratulate yourself on things that went according to plan and correct problems before they get out of hand. You might also want to reassess your goals periodically if your business goals have changed over time.

Form 9 Balance Sheet

Assets		Liabilities	
Current		Current	
Cash	\$	Accts. Payable	\$
Accts. Receivable	\$		\$
Inventory	\$		
	\$	Interest Payable	\$
	\$	Taxes Payroll	\$
Prepaid Expenses	\$	Payroll Payable	\$
	\$		\$
	\$		\$
Intermediate		Intermediate	
Equipment	\$	Notes Payable	\$
	\$		\$
	\$		\$
	\$		\$
Long Term		Long Term	
Real Estate	\$	Mortgage Payable	\$
	\$		\$
	\$		\$
	\$		\$
Total Assets	\$	Total Liabilities	\$
		Owner's Equity	
		Net Worth	\$

Form 10 Income Statement

Revenue	
Gross Sales	\$
Minus Losses	\$
Total Sales	\$
Variable Expenses	
Production Labor	\$
Supplies and Materials	\$
Inventory	\$
Fuel	\$
Fees	\$
Total Variable Expenses	
	\$
Contribution Margin	
	\$
Fixed Expenses	
Rent	\$
Utilities	\$
Insurance	\$
Start Up Loan	\$
Legal/Accounting	\$
Bank Fees	\$
Overhead Labor	\$
Communication	\$
Miscellaneous	\$
Total Fixed Expenses	
	\$
Pre-Taxed Net Income	
	\$
Taxes	
	\$
Net Income	
	\$

Form 11 Financial Statement Analysis

Liquidity

Current Ratio

Total current assets	\$ _____	
Divided by current liabilities	\$ _____	= _____

Solvency

Leverage Ratio

Total liabilities	\$ _____	
Divided by net worth	\$ _____	= _____

Profitability

Net income	\$ _____	(a)
Interest paid	\$ _____	(b)
Unpaid labor	_____ Hrs. @ _____/hr. =	\$ _____
	_____ Hrs. @ _____/hr. =	\$ _____
	_____ Hrs. @ _____/ht. =	\$ _____
Total unpaid labor	\$ _____	(c)
Total assets	\$ _____	(d)
Total net worth	\$ _____	(e)

Return on assets:
 $(a+b - c) / d =$ _____

Return on equity:
 $(a-c) / e =$ _____

Financial Efficiency

Asset Turnover Ratio

Sales	\$ _____	(f)
Divided by total assets	\$ _____	= _____ (g)
Total expenses	\$ _____	(h)
Interest paid	\$ _____	(i)
Depreciation	\$ _____	(j)
Net income	\$ _____	(k)
Capital gain or loss	\$ _____	(l)

Operating Expense ratio	$= (h-i-j) / f$	= _____
Depreciation ratio	$= j / f$	= _____
Interest paid ratio	$= i / f$	= _____
Net income ratio	$= k / f$	= _____
Capital asset gain or loss ratio	$= l / f$	= _____