
CE-Oh!
be your own boss

Warm-up Activity

What are the monthly costs for your household?

What are one time purchases you've made in the past?

How do you know if you're spending too much money for your needs and wants?

Have you attempted to use your ATM card as your only budget tool?

Vocabulary

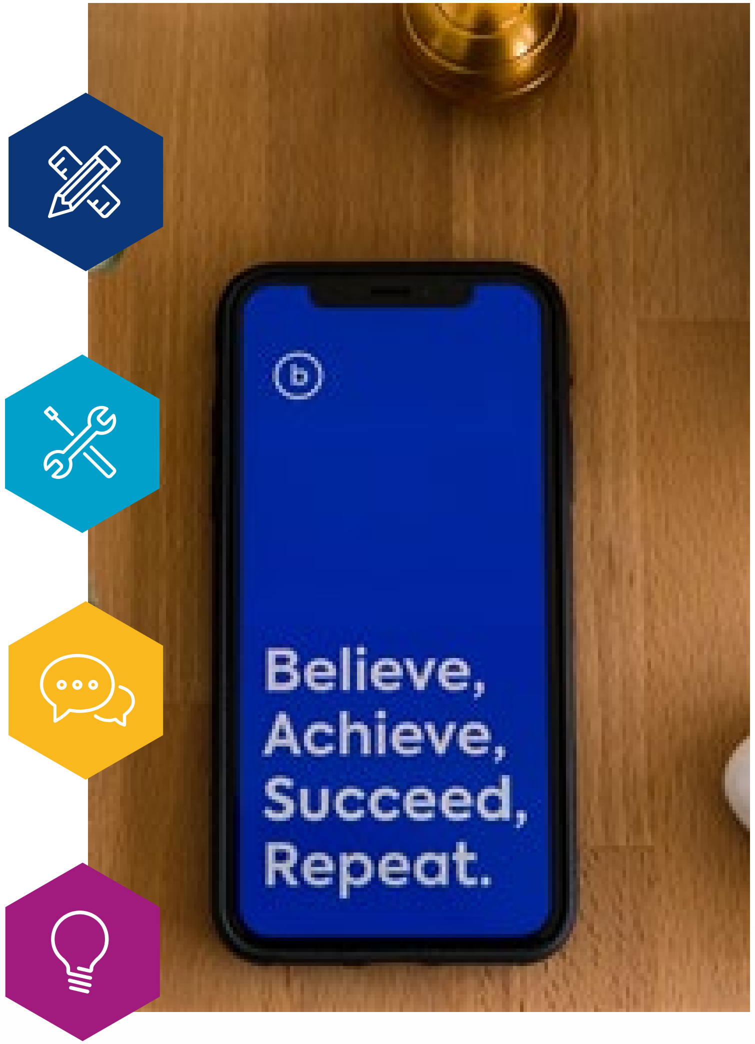
Here is the vocabulary for this module.

- angel investors
- bank to debt ratio
- bootstrapping
- collateral
- convertible notes
- co-signer
- credit union
- debt financing
- emergency fund
- equity financing
- payback
- reserve for fixed expenses
- return on investment
- start-up costs
- start-up investment
- venture capital

Key Learning Objectives

Now we will learn what goes into financing a business and analyzing those financials. Our objectives for this module are:

- Estimate the start-up investment needed given a scenario
- Explain ROI and how to calculate it
- List ways to obtain investments to start a business



Start-up Costs

Start-up costs are the investments you make as an entrepreneur in one-time purchases that are necessary for your business.

The money you spend on start-up costs, the money you put aside for fixed expenses, a reserve for fixed expenses and an emergency fund add together to create your **start-up investment**.

Emergency Funds and Fixed Expenses

It is necessary that as an entrepreneur you have extra money for emergencies, the money you set aside for this purpose is an **emergency fund.**

A **reserve for fixed expenses** is a space to save enough money to keep your fixed expenses satisfied for at least three months in the event that your business has a slow start.

$ 9,600 start-up expenditures
2,100 fixed expenses
$11,700 start-up amount needed

$9,600 / 2 = $4,800 emergency fund

$2,100 * 3 = $6,300 reserve for fixed expenses

$11,700 + $9,600 + $2,100 = **$22,800**

Start up investment $22,800

Estimating Net Profit

- Estimate your maximum number of sales
- Estimate the local demand, re-evaluate your estimate
- Price your product or service
- Multiply the price of your product or service by the expected sales
- Estimate the cost of producing or purchasing the products that you expect to sell
- Subtract the estimated expenses from the estimated revenues

Estimating Net Profit

- Estimate your maximum number of sales – we estimate that we can sell 1,000 shirts
- Estimate the local demand, re-evaluate your estimate – our market research indicates that we may be able to sell 1,500 t-shirts
- Price your product or service –$19.99
- Multiply the price of your product or service by the expected sales – $19.99 x 1500 = $29,985.00
- Estimate the cost of producing or purchasing the products that you expect to sell - $12,750 (quantity discount; our COGS for each shirt drops to $8.50)
- Subtract the estimated expenses from the estimated revenues – $29,985.00 - $12,750.00 = $17,235.00

Consumables and Non-consumables

Allow the purchase of consumable or non-consumable items

- Consumables – purchases are used once, are depleted, and can be purchased again.
- Non-consumables – purchased once and do not expire.

Return on Investment

Return on investment (ROI) is calculated by dividing the net profit by the start-up investment

Net Profit/Start-up Investment x 100 = Return on Investment (%)

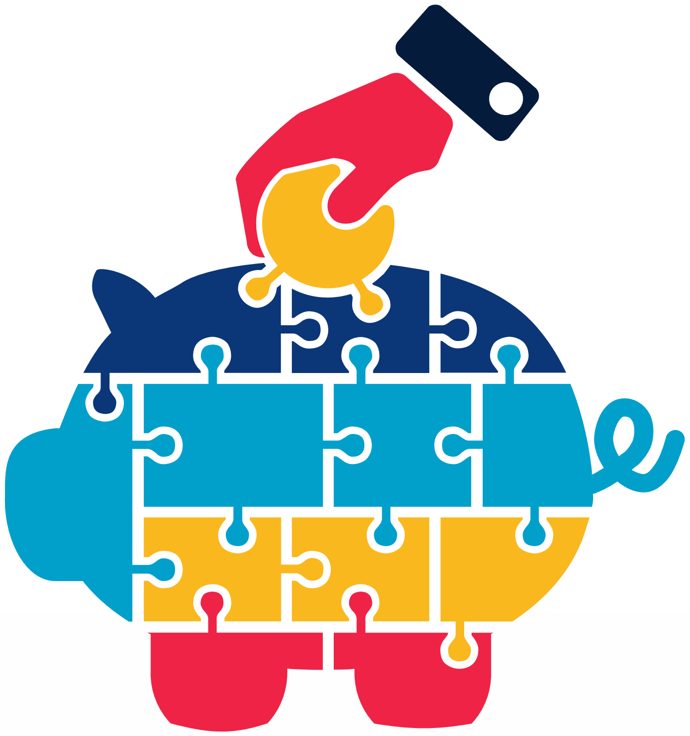
Sources of Debt Financing

Borrowing money to finance your company and gaining debt in the process is called debt financing.

In all cases, you should try to keep your start up investment as low as possible to minimize the amount of debt you will have to bear.

Personal Savings

Financing your business through your own savings is called **bootstrapping**; paying homage to the saying “pulling yourself up by your bootstraps”.



Banks

The biggest source of debt financing for most entrepreneurs is a bank. For the bank to determine whether or not to give you a loan it may use a **bank to debt ratio** (more commonly called income to debt ratio or debt to equity ratio)

Banks Continued

Collateral (is something that you promise to the bank that they will take from you and sell if you fail to make your loan payments.

A **co-signer** is someone who will sign loan agreements with you so that in the event you cannot make your monthly payment, they will be legally bound it pay it for you.

Credit Union

A **credit union** is a nonprofit organization that many entrepreneurs turn to as an alternative to banks because of their lower interest rates.

SBICs often specialize in providing loans for a certain type of business or business owner such as people of color, women, and other minorities.

Microloans

- Given out by nonprofit organizations through the Small Business Administration (SBA).
- Ideal for someone who doesn't own something of value for collateral and/or doesn't have an extensive credit history, and only needs a relatively small loan (around $10,000).

Relatives and Friends

Many businesses have started from the generosity of friends and family.

The most important part of taking loans from family and friends is explaining to them what the risk is for their investment and agreeing on an interest rate for repayment.

Credit Cards

Loan amount

$10,000

Term in months

12

Interest rate per year

20%

Monthly Payments

$926.35

Total Principal Paid $10,000

Total Interest Paid $1116.14

Oftentimes credit cards are not the best option for entrepreneurs because they may charge very high interest rates, upwards of 20%.

Not the recommended method of debt financing.

Payback

The **payback** is the number of months it takes for your business to earn back the start-up investment.

Start-up Investment/Net Profit per Month

= Payback

Equity Financing

Instead of debt financing, there is **equity financing** where you sell shares in your business in order to finance it.

Relatives and Friends 01

Angel and/or Venture Capitalists 02

Partners 03

04 Customer Financing

05 Barter Financing

Relatives and Friends

This process is very similar to debt financing with family and friends. If they have opinions or complaints about how you are running the business they are in their right to voice them and you are obliged to listen.

Angels and Venture Capitalists

Angel Investors

Provide for various start-ups and are more willing to accept low returns.

Convertible Notes

Debt instruments that some early stage investors use.

Venture Capital

Money that is invested in a business by a company.

Partners

Business partners join together and build their company, they do this by sharing control, ideas, expertise, and strengths with each other.

Customer Financing and Crowdfunding

Precisely how it sounds, customer financing is when a patron of your store willingly provides money for your business in the form of either debt or equity because they like you, your product, or anything else about your business.

Crowdfunding platforms include sites like GoFundMe or Patreon. Small contributions across an incredible amount of people could mean an amazing amount of capital.

Customer Financing and Crowdfunding

This is when two businesses or companies that provide products or services make an exchange for the benefit of both parties.

Knowledge Check

Multiple Response Question

Which of the following should you have prepared when starting a business?

- An emergency fund
- A reserve for fixed expenses
- Venture capital
- An estimate of start-up costs
- A balance sheet
- A payback estimate
- A quick ratio
- An operating ratio

Multiple Choice Question

Estimate the start-up investment needed given the following scenario: Kerry is starting her very own hot dog truck business. Her total start-up expenditures are $16,000. Her fixed expenses are $800 a month.

- $16,800
- $19,200
- $24,800
- $27,200

Match the term with the correct definition:

Someone who is legally bound to pay your monthly loan payment if you fail to.

The money an entrepreneur spends on start-up costs, fixed expenses, and a reserve for fixed expenses; also called seed money and start-up capital

Something that you promise to the bank that they will seize from you and sell if you fail to make your loan payments

Money that is invested into a business by a company whose sole purpose is to invest in start-ups

The investments an entrepreneur makes in one-time purchases that are necessary for their business

Terms:

Collateral
Co-signer
Start-up costs
Start-up investment
Venture capital

Multiple Choice Question

True or False? If you end up with less than 100% ROI that means you have earned all of your start-up investment back and you have “broken even” on your investment.

- True
- False

Multiple Choice Question

True or False? (Net Profit/Start-up Investment) x 100=Return on Investment (%)

- True
- False

Multiple Choice Question

Which of the following ways was NOT discussed as a way of debt financing (obtain investments to start a business)?

- Personal savings
- Banks
- Credit unions
- Microloans
- Relatives and friends
- Seed money
- Credit cards

Reflection

At the beginning of this module, we asked you to take a moment to reflect on your household financials. Now we'd like you to answer the same questions while focusing on your business.

What are the monthly costs you anticipate for your business?

What one-time purchases do you anticipate making?

How will you know if you're spending too much money to stay in business?

What do you consider the easiest and hardest ways to finance your business?

Compare and Contrast

Take a moment to reflect on your learning and comparing and contrasting your answers.

What we learned about:

Angel investors	Bank to debt ratio	Bootstrapping
Collateral	Convertible notes	Co-signer
Credit Union	Debt financing	Emergency fund
Equity financing	Payback	Reserve for fixed expenses
Return on investment (ROI)	Start-up costs	Start-up investment
Venture capital		

Independent Practice

You should use the information in this module to develop a financial plan for your own business. Create a list of start-up costs and decide which option is best for you to finance them. Use the resources provided to research investors and create your plan for funding your start-up.

In this module, we learned how to estimate start-up costs and the start-up investment needed.

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We learned how to explain ROI and how to calculate it.

We learned ways to obtain investments to start a business.

In the next module, we're going to talk about best practices surrounding how to manage the finances of your business.

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Angel Investor

An individual who provides capital for a business start-up, usually in exchange for convertible debt or ownership equity

Bank to Debt Ratio

Monthly debt payments divided by monthly income; used by the bank to determine if you should receive a loan

Bootstrapping

Financing a business through one's own savings, or bartering for professional services based upon your occupational skills set, adding in a temporary revenue stream outside of the core business to fund the primary business, whilst doing as much of the work by oneself to save as much as possible

Collateral

Something that a debtor promises to the bank that they will seize from the said debtor and sell if they fail to make their loan payments

Convertible Notes

A debt instrument often used by angel or seed investors looking to fund an early-stage startup that has not been valued explicitly. The terms and risks of these notes vary widely and should be reviewed by an outside legal counsel.

Co-signer

Someone who will sign loan agreements with an entrepreneur so that in the event they cannot make their monthly payment, they will be legally bound to pay it for you

Credit Union

A nonprofit organization that many entrepreneurs turn to as an alternative to banks because of their lower interest rates; you must be a member and they have the ability to sue you like a bank if you don't pay your debts

Debt Financing

Borrowing money to finance your company and gaining debt in the process; it includes personal savings, banks, credit unions, microloans, relatives and friends, and credit cards

Emergency Fund

The money an entrepreneur sets aside for business emergencies; should be equal to half the start-up cost

Equity Financing

Selling shares of your business in order to finance it; it includes relatives and friends, angels and venture capitalists, partners, customer financing and barter financing

Payback

Start-up investment divided by the net profit per month; the number of months it takes for a business to earn back the start-up investment

Reserve for Fixed Expenses

A space to save enough money to keep fixed expenses satisfied for at least three months in the event that a business has a slow start and is unable to earn enough money to cover those necessary costs

Return on Investment (ROI)

Net profit divided by start-up investment; used to determine the profitability of a business

Start-up Costs
(Start-up Expenditures)

The investments an entrepreneur makes in one-time purchases that are necessary for their business

Start-up Investment

The money an entrepreneur spends on start-up costs, fixed expenses, and a reserve for fixed expenses; also called seed money and start-up capital

Venture Capital

Money that is invested into a business by a company whose sole purpose is to invest in businesses