CHAPTER 9
ANALYZING START-UP FINANCIAL RISKS AND BENEFITS

Author’s Note

One of the most difficult tasks for the start-up entrepreneur is calculating how much money it’s going to take to start the new venture. The estimate is complicated by the difficulty of estimating demand for the new product or service, which is often something that has not previously existed in exactly the same way.

This chapter looks at how to estimate sales and capital expenditures for a new venture and how to present these and other necessary figures in pro forma financial statements. It also helps you analyze how much start-up capital is needed. The chapter concludes with the analyses needed for the test of the business concept. At this point, the entrepreneur should have enough information to make a “go/no go” decision.

Learning Objectives

This chapter will give students an understanding of:

- How to find the right numbers for a financial analysis
- Methods for estimating sales and expenditures
- How to prepare the pro forma income statement
- The amount of start-up capital and other resources required

Supplementary Lecture Material

Finding Money in Your Own Back Yard

For 99 percent of all new businesses, venture capital is not an option and, if you don’t have a network of potential angel investors, where do you go for the capital to launch? Certainly that was the case for furniture manufacturer Lewis Buchner until he discovered Silicon Valley Community Ventures (SVCV), a venture firm that targets small businesses in low-income communities in the San Francisco Bay Area. SVCV invested $250,000 for a 6 percent equity stake in the company. What attracted them was the company’s commitment to social responsibility in the forms of sustainable forestry and increasing the skill levels of its blue-collar workforce.

There are about 50 firms like SVCV nation-wide that are dedicated to community development projects that return what is known as a “double bottom line”—financial returns (five times their investment over five years) and altruistic compensation in the form of jobs for low-income workers and opportunities for women and minorities.

In addition to funding, Buchner gained access to the SVCV advisory program that links the portfolio companies with Bay Area executives who volunteer their advice and guidance.

Source: Kate O’Sullivan, “The Bucks in Your Backyard,” Inc. Magazine, April 1, 2002.

Films to Rent

Andrew Carnegie: Maverick Millionaire

Andrew Carnegie, once the richest man in the world, revolutionized the steel industry and then went on to become the world's greatest benefactor when he gave all his money away.

www.films.com
52 minutes
Item: **BVL5143**
Format: **VHS**
List Price: **$89.95**

Bootstrap Capitalism

The premise of this film is that micro-lending to entrepreneurs with no collateral has value. The film talks about one such program and its business boot camp.

www.films.com
15 minutes
Item: **BVL8615**
Format: **VHS**
List Price: **$69.95**

Dotcoms Gone Bust

This film is a sequel to "The Internet Money Machine." It tracks what happened to TheGlobe.com and Pseudo.com after the dot com bust.

www.films.com
23 minutes
Item: **BVL29093**
Format: **VHS**
List Price: **$149.95**
Rental Price: **$75.00**

Cases Relevant to This Chapter

Beanos Ice Cream Shoppe

Answers to Issues to Consider

1. *Why is the cash flow statement the most important statement for the entrepreneur?*

   The cash flow statement is the most important financial statement for the entrepreneur because it depicts the cash position of the company at specified points of time and lets the entrepreneur know when the company is expected to generate a positive cash flow based on sales. Cash is the life blood of the business, and the entrepreneur must be constantly aware of the cash position of the new venture.

2. *What are some ways to effectively forecast sales for a retail business? A manufacturer? A service business?*

   You will need to estimate revenues, expenses, and start-up costs from the industry, the market and customer, and your own knowledge—in other words, triangulate.

   For a retail business, if the product does not currently exist in the market, you will need a competing product or service that is similar or is a substitute one to study. Consider volume of sell-in to the retailer and the volume of sell-through to the customer. Sales figures will also be a function of growth rates in your market segment, innovations offered, and any technological innovations that permit you to produce the product or service at a lower cost. Service businesses generally follow the same patterns as consumer products.

   For a manufacturer, it is important to understand the buying cycles of the industry. You will need sales figures from noncompeting product manufacturers in the same industry, and you will need to determine the size of the market niche you intend to enter.

3. *How is forecasting sales for consumer products different from forecasting sales for industrial products?*

   With consumer products, you are looking at the volume of sell-in to the retailer and the volume of sell-through to the customer. Industrial products are generally sold business to business so customer needs and buying cycles of the industry become important.

4. *What are the three basic types of money found in the cash needs assessment and how are they used to control how much money is needed to start the business?*

   Three types of money are hard costs (capital costs like equipment, facility), soft costs (deposits, supplies) and working capital. Knowing the types of money gives you an opportunity to consider alternate routes. For example, equipment does not need to be purchased for all cash. One option is to lease, which significantly reduces the start-up capital required.

Suggestions for Experiencing Entrepreneurship

1. *Interview a banker and an accountant about the key financial statements that entrepreneurs need to understand to run their businesses. Ask about the biggest mistakes business owners make in preparing their financial statements. Compare and contrast the responses of the banker and the accountant. Are their views of the financials different? Why?*

   One would expect the banker to find fault with the business owner’s ability to demonstrate in the financials that they can repay a loan from the cash flow of the business. The accountant is more likely to be concerned with the correctness of how the business owner portrayed the business in the financial statements. Other comparisons are possible as well.

2. *Interview an entrepreneur who has been in business no longer than five years to find out how he or she calculated how much money was needed to start the venture. Did it turn out to be enough? Why or why not? What would you have advised the entrepreneur to do differently?*

   This is a chance for students to apply what they are learning in the classroom to a real situation. Testing their understanding of the chapter material will enhance their ability to be successful when they start businesses.