CHAPTER 17
Developing a Business Plan

What You’ll Learn

When you have completed this chapter, you will be able to:

Section 17.1

• Discuss the importance of financial management for a business.
• Explain the components of a business plan.
• Describe the aspects of a financial plan.

Section 17.2

• Explain the importance of accounting in financial management.
• Identify the primary functions of accounting.

Reading Strategies

To get the most out of your reading:

Predict what you will learn in this chapter.
Relate what you read to your own life.
Question what you are reading to be sure you understand.
React to what you have read.
In the **Real World** . . .

John Irvin loves sports. When he was a high school student, he started selling sports cards because he had collected a lot of doubles and triples. Eventually, he opened a stand at a local swap meet and at collectibles shows on weekends. Now John wants to open a sports memorabilia store. What could be better than running a business he loves?

After talking to the advisors at SCORE and the Small Business Association, he realized that his knowledge about autographs, bobblehead dolls, and limited-edition trading cards would not be enough for his store to be a winner. He would need to learn how to start and operate a real business. Making a plan would be a good first step to make his dream a reality.

*As You Read*  Consider what steps are involved in planning a business.

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**Business Plan**

*Q:* My older sister and I are running a very successful business making children’s birthday cakes. Since we are already doing well, why do we need a business plan?

*A:* Just because your business is successful now does not mean that it will remain successful. By creating a business plan, you can define clear goals for things like sales and profitability that will help you keep your business on track. Your business plan can help you to assess how inflation may affect your business over time.

**Ask Yourself**  Can you think of any other advantages that writing up a business plan would provide?

Go to [finance07.glencoe.com](finance07.glencoe.com) to complete the Standard & Poor’s Financial Focus activity.
A Plan for Business

The Business Environment

What do all businesses have in common?

When you hear the word “business,” do you think of large businesses, such as Microsoft, Ford, Coca-Cola, Disney, or IBM? Maybe you think of smaller businesses, such as your neighborhood convenience store, flower shop, or hardware store. All of these businesses, large and small, are part of the free enterprise system, which is an economic system in which people can choose what they buy, what they produce and sell, and where they work. Businesses in such a system must compete to attract customers.

One of the main measurements of success for a business is the amount of profit it generates. Profit is the amount of money earned over and above the amount spent to keep the business operating. Profit motivates most people to take the risk of starting a business. Large and small businesses must do two things to survive: 1) operate at a profit with effective financial management and 2) attract and keep individuals who will run the business.

Developing a Business Plan

What is a business plan?

Whether you are starting your own business or taking over a family business, you must first develop a business plan. A business plan is a written proposal that describes a new business and strategies to launch that business. It helps you focus on exactly what you want to do, how you will do it, and what you expect to accomplish. It sets goals for the business just as you set goals for yourself. A business plan is an important part of a proposal to secure funding from investors. Before they invest or loan money, they want to see that prospective owners have fully developed ideas.

Component of a Business Plan

A business plan can have as many as 15 components: an executive summary, mission statement, company description, product and service plan, management team plan, industry overview, market analysis, competitive analysis, marketing plan, operational plan, organizational plan, financial plan, growth plan, contingency plan, and supporting documents, as well as a cover page, title page, and table of contents.
Three basic parts of a business plan, that can include many of the 15 components, focus on a strategic plan, a marketing plan, and a financial plan. The overall strategic plan is a written outline of the business goals and the steps to take to achieve them. The second part is the marketing plan, a written outline of how the business will be promoted to increase customers and sales. The third part is the financial plan, which is a written outline of how the business will get money to start up and operate, and how the business will maintain financial operations and business records. Basically, the financial plan determines how you will keep track of your money. Figure 17.1 illustrates the components of a business plan.

### The Strategic Plan

Both new and ongoing businesses must have sound strategic plans to be successful. In the classic novel, *Alice in Wonderland*, Alice asks the Cheshire Cat which way she should walk. The Cheshire Cat replies, “That depends a good deal on where you want to get to.” This is an appropriate observation about decision making and planning. Every person and every business needs goals and a specific course of action to achieve those goals.

**Figure 17.1 Business Plan Components**

*The Complete Plan:*
- Cover Page, Title Page, Table of Contents
- Executive Summary
- Mission Statement
- Company Description
- Product and Service Plan
- Management Team Plan
- Industry Overview
- Market Analysis
- Competitive Analysis
- Marketing Plan
- Operational Plan
- Organization Plan
- Financial Plan
- Growth Plan
- Contingency Plan
- Supporting Documents

*The 3 Basic Parts:*

1) **Strategic Plan**
   - Your business goals and how you will achieve them

2) **Marketing Plan**
   - How you will promote your business and increase sales in order to make it profitable

3) **Financial Plan**
   - How you will fund the creation and operation of your business, maintain financial operations, and keep business records

**The Essential Business Plan**

Whether you are starting a business of your own, purchasing an existing business, or taking over a family business, it is a good idea to develop a business plan.

**What is the purpose of a business plan?**
If you are a business owner, your ultimate goal is to have a successful and profitable business. In order to realize that objective, you must first determine the strategic plan you will follow to keep the business growing and moving in the right direction.

A strategic plan is similar to a game plan you might have for your sports team. Simply saying “We want to win!” will not bring a victory. The coach must devise a plan that outlines how the team will achieve the big win. The team must work together to apply the strategies that the coach has developed. Similarly, a business owner or operator may say that he or she wants the business to succeed, but without a sound business plan, it probably will not happen. The first step in writing a strategic plan is to set goals.

**Setting Goals**
Businesses set both short-term and long-term goals. In the business world, short-term goals are goals you expect to reach within one or two years. Long-term goals are those that may take three or more years to reach. Because long-term goals require a considerable amount of time, they may be less specific than short-term goals. You will probably revise them as you go.

Goals for businesses have the same guidelines as goals you might establish for your personal finances:

- They should be realistic.
- They should be specific.
- They should have a clear time frame.
- They should help you decide what type of action to take.

**WORKING TOGETHER**
Both large and small businesses can prosper and grow as neighbors. *Can you think of some large and small businesses in the same mall in your town?*

**As You Read**

What are your financial goals for the future? List at least two short-term goals that will help you reach your long-term goals.
Whether you own a small convenience store in the city or run a multinational corporation such as Kodak, the goals can be similar. Common objectives might include increasing sales, adding new customers, or updating equipment.

However, goals can also differ, depending on the size of the business. For example, the goals of a small business might include buying a computer system, introducing a new line of merchandise, or moving to a better location. Medium-sized businesses may want to open more stores or begin operating online to increase sales. Larger corporations have more complex goals. They may want to expand their international markets, change distribution systems, or acquire other smaller corporations.

Businesses should design goals according to the basic guidelines, regardless of the size of the business. Goals should be well thought out and compatible with the philosophy of the business. In all cases, a business needs to determine if its goals are financially possible.

**Identify Steps to Achieve Your Goals**  When you studied personal finance in earlier chapters, you learned that people set financial goals and then decide on ways to achieve those goals. For example, suppose that you have a short-term personal goal of making the honor roll. This is an admirable goal, but how do you accomplish it? You analyze the situation and plan your course of action. You identify specific actions you can take, such as taking better notes, doing your homework more carefully, and asking more questions in class.
Suppose that your long-term goal is to become a successful graphic designer. What must you do to become a designer? You will need a career plan. Then you will have to identify short-term steps, such as taking related courses in high school, selecting schools or colleges you want to attend, and completing the application process. Later you will probably focus your attention on long-term steps, such as graduating, getting a job, and acquiring professional experience. Hopefully, by taking these short-term and long-term steps, you will achieve your goal of becoming a designer.

When developing a strategic plan for your business, you should use the same technique. First, identify your short-term and long-term goals. Then create a plan that consists of specific steps toward each goal.

**A Strategic Plan Case Study**  
Mike and Erin have plans to start up an eco-friendly landscape business. They realize the importance of setting realistic, achievable goals. Because their business would be new, their short-term goals include getting a new business loan with a low interest rate, purchasing basic equipment, locating suppliers for plants and flowers, and purchasing a low-cost phone system. Long-term goals include acquiring a storage facility, purchasing a hybrid (gas/electric) vehicle to transport equipment, and increasing the number of customers by 20 percent each year.
Steps to Achieve Business Goals  Mike and Erin recently graduated from high school and want to start a landscaping business. They have worked with other landscapers and have experience taking care of a variety of flowers, plants, and trees. They plan to start their business as a service, and then open a retail nursery as well.

In their strategic plan, Mike and Erin identify the steps they will take to achieve each of their goals. One of their short-term goals is to show a profit after two years. To reach that goal, they plan to increase the number of customers and keep expenses low.

Global Financial Landscape

Standard and Poor’s publishes the globally recognized S&P 500® financial index. It also gathers financial statistics, information, and news, and analyzes this data for international businesses, governments, and individuals to help them guide their financial decisions.

GREECE

Surrounded by the crystal-clear waters of the Aegean and Ionian Seas, Greece is one of the world’s most popular travel destinations. Many tourists come for the sun and surf. Others come to see the birthplace of the Olympics and democracy, and to explore the ancient ruins that stand as tributes to the past. Dating back more than 2,500 years, Greece’s glory days have become a major industry and source of income. Athens attracts the most tourists. Few could leave the capital city without visiting the Parthenon, the country’s most famous national treasure. Dedicated to the Greek goddess Athena, the white marble temple sits majestically on top of a rocky hill called the Acropolis.

DATABYTES

Capital  Athens
Population  10,988,000
Language  Greek
Currency  euro
Gross Domestic Product (GDP)  $212.2 billion (2003 est.)
GDP per capita  $19,900
Industry: Tourism, food and tobacco processing, textiles, and chemicals
Agriculture: Wheat, corn, barley, sugar beets, and beef
Exports: Food and beverages, manufactured goods, petroleum products, and chemicals
Natural Resources: Bauxite, lignite, magnesite, crude oil, and marble

Think Globally
Athens is a major tourist destination. What businesses might be successful there?
The Marketing Plan

A marketing plan outlines the ways in which you will promote your business. Promotional activities include advertising and promotions. Advertising is any paid message that a business sends about its products. Promotion is any form of communication a business uses to inform, persuade, or remind people about its products or to enhance its image. You will show a profit or expand your operations by increasing customers. Therefore, you want to communicate with as many potential customers as possible to tell them about your goods or services. For example, Mike and Erin plan to place ads with photographs of their projects in a local newspaper.

As with the creation of a strategic plan, you have to address some specific questions. If you have something to sell, how do you sell it? How do you reach people in an efficient manner? What promotions or advertising can you afford? To begin to answer these questions, you should research the existing market for your goods or services. See Figure 17.2 for an illustration of this process.

Larger corporations may hire private marketing firms to assist them in developing marketing plans. Some corporations, such as Levi-Strauss, McDonald’s, and Ford, have been very successful over the years. Effective marketing plans have allowed these corporations to introduce new products, maintain sales of existing products, and keep their names in the public eye.

The Financial Plan

You have probably noticed that the elements in the strategic plan and the marketing plan involve the need for the efficient management of money. In order to make intelligent financial decisions regarding the direction and future of your business, you must record and report your finances in an orderly, consistent manner. Many people consider a financial plan to be the most important document for a successful business venture.

Sound financial decisions provide the opportunity for:

• Sales to rise
• Expenses to fall
• Profits to increase
• Assets to be acquired
• Liabilities to be paid
• Credit to expand
• Customers to increase
• New products to develop

Aspects of a Financial Plan  A financial plan outlines the essential financial elements for starting and running a business. An effective plan addresses three aspects of operating your business: assets needed, purchasing methods, and daily financial operations. (See Figure 17.3 on p. 558.)

First, it identifies the assets you will need to purchase in order to begin or continue operating the business. Assets are property or items of value owned by a business. These might include products to sell or machines, supplies, office equipment, and transportation necessary for operations.
To prepare a marketing plan, you first need to research the existing market. By seeing what is out there, you can better develop an effective marketing plan. This plan will become your road map for reaching new customers and expanding your business. Take these steps to prepare your marketing plan, an important component of your overall business plan.

1. **Assess** the competition.

2. **Identify** services offered.

3. **Research** the current pricing and advertising.

4. **Identify** potential customers.
Second, your financial plan should address the method that you will use to acquire or purchase these items. How will your business pay for the things it needs? Do you have sufficient cash available? Should you borrow money from a bank or credit union?

The third and most important aspect of the financial plan involves the daily financial operations of the business. This feature addresses the recording, summarizing, reporting, and analyzing of your business’s finances.

**Identifying Needed Assets**  The first aspect of creating a financial plan is to identify the assets that are necessary to start the business and then to make it grow and increase its profits. Suppose that the two entrepreneurs, Mike and Erin, want to buy a computer system. The system should be able to handle their present business operations as well as increased business activity in the future. They should consider features such as processing speed, memory capacity, upgradeability, and the software that is included.

After Mike and Erin have determined the computer components that their business needs, they should analyze the prices of different systems. They will need to purchase the best system for the best price. When their analysis is complete, Mike and Erin can decide what computer system to buy. This research process should be a part of buying any major asset.

**Purchasing Assets**  The second step of a financial plan is to determine the method to use to purchase the items. Mike and Erin need to ask several specific questions: Can they purchase the computer system with their available cash—or should they get a loan?

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**Business Planning Software**  There is a lot of software available to help the budding entrepreneur write a business plan. These programs, such as Business Plan Pro, help you develop a professional business plan for any size or type of business. Many of these programs also provide sample business plans that you can review for ideas.

Before you write your own business plan, listen to planning expert Tim Berry discuss the planning process and how Business Plan Pro can help you through finance07.glencoe.com.

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**TechByte**

**Funding Your Business**  Most lenders and investors require a well-organized and feasible financial plan before they will provide the money to start a business.

**Why might a financial plan be the most important aspect of a business plan?**
Will they be able to get a reasonable interest rate? Can they take advantage of alternatives to purchasing, such as leasing? Can they get a better deal if they wait? In answering these questions, Mike and Erin will have to perform a careful analysis of their existing finances regarding their debts, available cash, and future expenses.

They must also investigate all sources of credit. Will the company that is selling them the computer extend credit to them? Should they apply for a short-term loan from a bank? By examining these and other questions, Mike and Erin are practicing effective financial management.

As a high school student, you make similar decisions about your personal finances. If you want to buy an inexpensive item, such as a CD, you might pay cash. You will give the purchase little financial consideration. However, if it is a more expensive item, such as a sound system or a used car, you should examine your situation more carefully. Consider some of the following questions: Do you really need it? What is the most you can spend? How much money do you have now? Is there anything else you might need? By considering these questions, you are performing a financial analysis of your purchase—and practicing effective financial management.

Product Research

Good research leads to appropriate purchases for your company. Can you name at least five items that business owners might purchase that require product research?

Be Your Own Boss

The Small Business Administration (SBA) is an agency of the federal government that helps entrepreneurs. Find out if you are ready to be an entrepreneur by taking the SBA’s Are You Ready? quiz, and learn more about what it takes to start up a business.

To continue with Task 4 of your WebQuest project, visit finance07.glencoe.com.
As a business owner or operator, you might find that some items you want to purchase are beyond your means. You may not have enough cash. Especially when you are starting a business, you will have to accept the fact that you will not be able to obtain everything that you want immediately. You will have to work within your financial resources until your business begins to make a profit and you can afford to expand your assets. If you are working with limited resources, you must make decisions based on your need for the items and your ability to pay for them, whether with cash or credit.

**Recording and Reporting Business Finances** The third aspect of a financial plan involves the financial operation of a business. How will Mike and Erin keep daily financial records? Will sales cover their expenses and produce a profit? Will cash be available for unexpected costs? Will they be able to pay their bills on time?

Mike and Erin must know where their business stands financially at all times. The recording and handling of financial information, in an accurate and efficient manner, is essential. It includes using accepted accounting procedures, analyzing financial statements, controlling cash, and paying debts. If data is not recorded in a timely manner, or if the information is not analyzed correctly, inappropriate financial decisions can result. For a new business or a small existing business, this could be disastrous. Thousands of small businesses close each year due to poor financial decisions.

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**Section 17.1 Assessment**

**QUICK CHECK**

1. Describe the three main parts of a business plan.
2. Explain why financial management is an important aspect of a successful business.
3. Identify three aspects of a financial plan.

**THINK CRITICALLY**

4. What might happen to a business that analyzes its finances only twice a year?

**USE COMMUNICATION SKILLS**

5. **Marketing Your Product** Carol and Blanca have been operating their own jewelry-making business for three months. During that time they have sold their creations to friends and relatives. However, they now want to market their products to a larger customer base.

   **Present** Help Carol and Blanca market their jewelry by creating an advertising flyer. The flyer should be informative and persuasive.

**SOLVE MONEY PROBLEMS**

6. **Financial Plan Development** Santiago and his classmates want to raise money for Habitat for Humanity. Santiago plans to sell doughnuts and hot chocolate three mornings a week at school to raise funds. His teacher asks for a list of assets he will need.

   **Write About It** Help Santiago make a list of the assets he will need to run his doughnut stand. Indicate which assets he might borrow and which ones he must buy.
As you learned in the first section of this chapter, sound financial management is critical to the survival of any business. Financial management includes all aspects of operating a business. It is the glue that holds the business together. At the same time, it is the oil that helps it run smoothly. Many business functions and procedures are based on economic theories and principles. Supply and demand, pricing, market segments, and competition are just a few of the economic principles you need to know about. An understanding of basic accounting principles and procedures is also useful. You should have the financial knowledge and skills to be able to collect, summarize, and analyze financial data.

**Accounting: The Backbone of Financial Management**

*What is accounting?*

Accounting is the systematic process of recording and reporting the financial position of a business. The financial position depends on the transactions that occur in the daily operation of the business. A transaction is any activity that has an effect on the financial situation of a business. Every time you buy supplies, sell merchandise, buy a photocopier, or pay utility bills, your business is making a transaction. Accounting records and reports can help a business operate efficiently—and profitably—by keeping track of how much the business earns and spends.

Accounting is often referred to as the “language of business.” Accounting plays a vital role in the day-to-day activities of every business. The influence of accounting is demonstrated by the fact that many of its terms have become commonplace. You have probably heard terms such as “assets,” “liabilities,” “expenses,” “revenue,” and “inventory.” These are all accounting terms. Business owners use this language to communicate with other owners of the business, their creditors, and customers. They do this by issuing financial statements.
Investigate: A Job Description

A job description contains the following information:

- Job title
- Description of responsibilities
- List of required skills and education

Your Motive: When you write a business plan, it is important to think about how you will build a staff of employees. You start by defining the positions and listing the qualifications of the people who will fill those positions.

<table>
<thead>
<tr>
<th>Title/Compensation</th>
<th>Description</th>
<th>Job Specifications</th>
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| **Entrepreneur/Owner** | • Oversees all operations  
  • Responsible for setting up all policies, procedures, and guidelines  
  • Performs all hiring and employee evaluation functions  
  • Responsible for setting long- and short-term organizational goals  
  • Allocates resources | • Excellent communication skills  
  • Ability to motivate and lead |
| **Accountant** | • Responsible for supervising payroll, accounts payable, and accounts receivable functions  
  • Responsible for, and coordinates with, vendors and subcontractors  
  • Works with owner to obtain financing and lines of credit  
  • Responsible for payment and compliance with local, state, and federal requirements | • Excellent verbal and written communication skills  
  • Ability to work with others  
  • At least 2 years experience in construction or a related service or manufacturing industry  
  • Certification as a CPA |
| **Director of Operations** | • Develops operational procedures  
  • Responsible for implementing all policies, procedures, and guidelines  
  • Manages all operations and assists with hiring and employee evaluation  
  • Troubleshoots all problems, customer service issues, and employee complaints | • Ability to work with people of all backgrounds and skills  
  • Ability to motivate and lead  
  • At least 4 years experience in the construction industry or 2-year degree in management  
  • A minimum of 2 years management experience |

Key Points: Job descriptions are an important part of a business plan because investors will want to know how you will staff your organization. The descriptions can be advertised in the classified section of a newspaper or magazine, or posted on Internet job sites.

Find the Solutions

1. How will the owner be compensated?
2. What skills and background are required for the job of accountant?
3. What are the job functions of the director of operations?
4. Why is the accountant’s salary pro-rated over the year?
5. How much experience does the director of operations need?
GAAP

When recording and reporting financial changes in a business, owners, bookkeepers, and accountants must use a standard set of guidelines, which are referred to as generally accepted accounting principles (GAAP) (pronounced “gap”). If General Motors, Ford, and DaimlerChrysler all prepared their financial reports in different ways, no one could compare the three corporations financially. Using the GAAP guidelines allows investors, banks, suppliers, and government agencies to make comparisons of the financial condition of various companies. They can determine which businesses are financially stable, which ones have the highest percentage of profit, and which ones are growing the fastest.

Every business must have an accurate accounting system, either manual or computerized. Computer software programs can handle much of the basic accounting work for most businesses. By using this modern technology, owners and managers can spend more time analyzing their finances and planning for the future, and spend less time doing monotonous paperwork.

The accounting system has many functions and procedures. However, some of the most essential functions of accounting that most businesses use include budgeting, inventory, payroll, cash flow, and investments.

Budgeting

One important function of accounting is budgeting. A budget for a business is a formal, written statement of expected income and expenses for a future period of time. For example, the entrepreneurs Mike and Erin can write a budget to project, or predict, the amount of money they think they will earn through sales or other income in their landscaping business. They also project their production or operating costs (expenses) for the same period. The difference between these two amounts will be their projected profit or loss for the period. This gives them a glimpse into the financial future of their business. It provides the information they will need to make decisions.

To be practical, you should regularly compare a budget with actual income and expenses. If you are working with a yearly budget, you should make monthly comparisons of the budgeted amounts to the actual amounts. If the actual amounts are not reasonably close to the budgeted figures, you need to make adjustments. If the actual amounts are far greater than the projected figures, you must take immediate action to avoid further financial problems. An important aspect of financial management is to recognize a problem and take action to remedy it. Accurate, current accounting statements and reports allow you to recognize a problem when it first develops so that you can make financial decisions and take corrective measures.
Inventory

The largest asset of many businesses is the merchandise they have on hand to sell. Merchandise is the goods retailers buy with the intent to resell to customers. The inventory is the merchandise retailers have for sale. Most cash transactions involve the purchase, control, and sale of merchandise. Therefore, it is essential that inventory be carefully maintained and examined. By tracking inventory, businesses know the following facts about their merchandise:

- Amount of merchandise sold
- Merchandise that is selling well
- When to reorder merchandise
- Merchandise that should not be reordered

**Amount of Inventory** The wrong level, or amount, of inventory can be costly for a business. Having too little inventory means that the business may not be able to satisfy its customers’ wants. For example, when you go to a store to buy CDs, and they have very few on the shelves, you might not bother to look around the store. Instead, it is likely you will go to another store to make your purchase. Lost sales mean lower profits for the store.

If inventory is too high, too much money has been spent on inventory and is not available for other things, such as a new computer system, because cash is not available. Inappropriate inventory levels, either too high or too low, are signs of poor management.

Most stores use computer programs to monitor inventory. These programs provide daily reports that detail what items have been sold, what is still available, and what must be reordered.

Question:

Why is having proper inventory levels an important aspect of financial asset management?
Payroll

While merchandise is usually the largest asset of a business, payroll is usually the largest expense of a business. Large companies such as AT&T, Coca-Cola, and American Airlines employ thousands of people. Weekly payrolls are in the millions of dollars. Some small businesses employ fewer than a hundred people, and some very small businesses might employ fewer than ten people. Whether your business is large or small, payroll is usually your greatest expense.

Because payroll involves so much cash, it is regulated by state and federal laws and must be prepared according to generally accepted accounting principles (GAAP). Most businesses use computer programs to process payroll checks, to complete payroll reports, and to examine payroll information. Efficient payroll management involves two important activities.

Determining Number of Employees First, you must determine whether you have the proper number of employees working at the proper times. Having too many employees or employees working at the wrong times means that you are paying more in wages and salaries than you should. Your payroll expense must be reduced. If you do not have enough employees or are understaffed at certain times, your company risks losing sales. Both situations are indicators of poor management.

Using GAAP The second activity that ensures efficient payroll management is using generally accepted accounting principles (GAAP) to prepare payrolls. Paychecks must be issued on time. All payroll taxes must be paid, and voluntary deductions must be taken. All payroll records should also be available for managers and owners to evaluate immediately. Accurate, complete, and readily available payroll information is essential. Chapter 21 explains more about payroll procedures and regulations.

Cash Flow

Every person needs cash. Every business needs cash. Available cash often determines what a business can or cannot do. An adequate amount of available cash allows your business to pay its debts, take advantage of discounts, and pay for expansion.

In personal finance, “cash flow” refers to the amount of money that actually goes into and out of a person’s wallet or bank accounts. For a business, cash flow is the amount of cash that is available at any given time. Money comes in, and money goes out—this is cash flow. A goal of effective financial management is to maintain a constant flow of cash through the business. This is easy to say, but it is not always easy to do. Economic and financial conditions constantly change. Sometimes sales are high, and then they may suddenly drop off. Expenses may also vary. When a business spends more money than it receives, it experiences a condition known as a negative cash flow, also called a cash crunch. When your cash flow is negative, your business suffers.
As a student, you have probably experienced similar cash crunches. For example, suppose that you want to go to the movies on Friday night with your friends, but on Wednesday you buy the wool sweater you want. So, on Friday night, you discover that you do not have enough money to go out. For you, this is a short-term disappointment. For a business, however, a shortage of money could mean serious problems. Without a sufficient flow of cash, merchandise cannot be replaced, bills cannot be paid, and funds for future growth and expansion cannot be invested. Maintaining a positive cash flow is a primary goal of financial management.

**Investments**

Successful businesses invest for the future. As profits increase, money should be set aside or invested for future business needs. This reserve cash may be needed to purchase new equipment, relocate the business operation, or sell a new line of merchandise. For example, suppose that Mike and Erin form a business partnership. Their goal is to purchase a building for their landscaping business within the next five years. They should set aside a certain amount of money each year to ensure that sufficient funds will be available to buy the building or make a down payment.

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**Careers in Finance**

**BOOKKEEPER**  Brad Chapman  
*Longs Drugs*

After moving from his hometown, Brad found it easy to find another bookkeeping job. He has always enjoyed the challenge of balancing ledgers and creating spreadsheets. The skills and experience he picked up while keeping books for a local music store seem to apply everywhere. At Longs Drugs, he balances cash registers, determines if registers are over or short, completes daily reports, and counts and deposits daily receipts. He also handles payroll, tags and logs invoices and claims, and forwards pertinent paperwork to the general offices. Other tasks of a bookkeeper might include preparing weekly gross profit study surveys and following up on returned checks.

**SKILLS:** Accounting, computer, math, organizational, customer-service, and problem-solving skills

**PERSONAL TRAITS:** Detail-oriented, discreet, honest, and likes working with numbers

**EDUCATION:** High school diploma or equivalent; associate degree or technical training at a college; on-the-job training

**ANALYZE** Why would most businesses need a bookkeeper?

To learn more about career paths for bookkeepers, visit [finance07.glencoe.com](http://finance07.glencoe.com).
**Investments and Reserve Funds**

Businesses need reserve cash for emergencies or unexpected costs. If equipment breaks and needs repair, sales take an unexpected drop, or a natural disaster hits your area, you will need cash. Cash reserves, also called reserve funds, could save your business when any type of disaster strikes.

Cash should be carefully invested and closely monitored. Investments by businesses are similar to personal savings. You should save money for unexpected bills or events, such as a broken water heater or a medical bill. You would also need to save for a new car, summer vacation, or computer for your personal needs.

**The Importance of Financial Management**

*What are some aspects of financial management?*

Businesses must make a profit and invest part of that profit for future use. Making and monitoring investments is an important aspect of financial management. In addition to investments, sound financial management relies on accounting. You will learn more about accounting functions and managing a business’s finances in the remaining chapters of this book.

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**Section 17.2 Assessment**

**QUICK CHECK**

1. Define the term accounting.
2. What are five of the most essential functions of accounting?
3. Explain why it is important for a business to maintain and examine its inventory carefully.

**THINK CRITICALLY**

4. Explain why a business should have enough cash reserves.

**USE MATH SKILLS**

5. **Accounting Basics** You are the bookkeeper at a toy store. Last month the following transactions occurred:
   - Sales: $62,500
   - Payroll, rent, utilities: $16,000
   - Merchandise purchased: $25,000

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**ANALYZE** Did the toy store have a positive or negative cash flow?

**SOLVE MONEY PROBLEMS**

6. **Accounting Statements** Vince and his sister Kim own a pool cleaning service. Kim analyzes the financial statements and reports each month. Recently she has noticed that sales are slipping and that expenses seem to be out of control. They need to take corrective measures as soon as possible.

**GROUP ANALYSIS** In small groups, work together to help Vince and Kim figure out what might be happening to their business. Come up with three suggestions for correcting the situation and present them to the class.

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*Is having a reserve fund as important as having a regular savings account? Why or why not?*
One of the measures of success for a business is the amount of profit it earns. Businesses must do two things to survive: operate at a profit with effective financial management and attract customers.

The components of a business plan include: executive summary, mission statement, company description, product and service plan, management team plan, industry overview, market analysis, competitive analysis, marketing plan, operational plan, organizational plan, financial plan, growth plan, contingency plan, and supporting documents—plus a cover page, title page, and table of contents.

The three basic parts of a business plan focus on a strategic plan, a marketing plan, and a financial plan.

The financial plan identifies the assets you need, how you will acquire these assets, and how you will handle daily financial operations.

Accounting is the systematic process of recording and reporting a business’s financial position, including all transactions involving money.

Accounting functions include the preparation of financial statements, auditing, budgeting, payroll, inventory, cash flow, and investments.

Communicating Key Terms

What sort of a business would you like to start someday, perhaps after working for an employer in your chosen field to gain some experience? If you were meeting with a bank loan officer to apply for a commercial loan to start your business, what would you say? Use as many terms below as you can to develop some points to discuss with the loan officer.

- free enterprise system
- profit
- business plan
- strategic plan
- marketing plan
- financial plan
- accounting
- transaction
- generally accepted accounting principles (GAAP)
- budget
- merchandise
- inventory
- cash flow
- negative cash flow

Reviewing Key Concepts

1. Explain how financial management is the basic foundation for business success.
2. Describe specific items you would include in your business’s strategic, marketing, and financial plans.
3. Identify the three aspects of a financial plan.
4. List three examples of accounting transactions.
5. Explain why a business needs to follow generally accepted accounting principles (GAAP).
Language Arts  One of the main measurements of success for a business is the amount of profit it earns.

Write About It  Write a paragraph explaining what is meant by this statement.

Business Capital  A primary concern of a business is its “working” capital, which is the current assets minus current liabilities. It is all assets that can be turned into cash quickly, reduced by all liabilities that must be paid within the year.

1. Calculate  From the following partial balance sheet, calculate the company’s working capital:

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$17,500</td>
</tr>
<tr>
<td>Marketable securities</td>
<td>93,000</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>87,455</td>
</tr>
<tr>
<td>Inventories</td>
<td>162,000</td>
</tr>
<tr>
<td>Fixed assets</td>
<td>147,000</td>
</tr>
<tr>
<td>Net of depreciation</td>
<td></td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
</tr>
<tr>
<td>Current liabilities</td>
<td>$114,000</td>
</tr>
<tr>
<td>Long-term debt</td>
<td>216,000</td>
</tr>
<tr>
<td>Partnership equity</td>
<td>176,955</td>
</tr>
</tbody>
</table>

2. Compute  Use spreadsheet software to make this calculation.

Connect with Economics and Law  In the late 20th and early 21st centuries, the stock value of Enron Corporation seemed to go up. However, Enron’s earnings were overstated because the company used illegal accounting practices that removed negative cash flow items from the income statement. Investors lost a great deal of money when the problem was discovered.

1. Research  Access an Internet search engine and find out how Enron hid its money-losing operations from public view.

2. Think Critically  As a result of Enron and a few other large companies’ overstatements of earnings, the federal government passed the Sarbanes-Oxley Act. Find out the requirements of the Sarbanes-Oxley Act. Do you think this Act will prevent another Enron-like scandal?

Web Site: Do You Need One?  The successful sales of your home-baked goods through diners and coffee shops have led you to consider filling orders for custom cakes. You are considering the creation of a Web site to promote and sell your products.

Log On  Use an Internet search engine to find Web sites of similar businesses. Then answer these questions: What are the advantages and disadvantages of producing and maintaining a Web site?

Newsclip: A Shaky Ship?  Despite a weak economy, a company can succeed if it adheres to a comprehensive business plan.

Log On  Go to finance07.glencoe.com and open Chapter 17. Learn all of the elements of a business plan. Choose a corporation featured in the news. Write a sample business plan for it.
WHAT’S YOUR BUSINESS PERSONALITY?

Businesses need employees who have all types of personalities. Which four of the following statements best describe your personality? Write your answers on a separate sheet of paper, and then add up the number of points.

- I prefer activities that allow me to tell other people what to do. (5 points)
- I can delegate responsibility. (3 points)
- I prefer a clear definition of my responsibilities. (1 point)
- I am very good at brainstorming ideas. (5 points)
- I am good with details. (1 point)
- I like to do things exactly right. (1 point)
- I enjoy persuading others. (5 points)
- I am good at planning. (3 points)
- I like to be in charge. (5 points)
- I am good at organizing. (3 points)
- I prefer to follow others’ instructions. (1 point)
- I know how to give clear directions. (3 points)

**Support staff:** If you scored 4–8 points, you are a real team player and can provide essential support to any business enterprise.

**Manager:** If you scored 10–14 points, you may be on track for a management career.

**Entrepreneur:** If you scored 16–20 points, you may succeed by running your own business when you are ready.
For several years Tom has been going with his father to yard sales. His father buys old clocks and radios. He fixes them if they need repairs and sells them at the Millerton Flea Market. Tom wants to start his own business and organize his plans.

### Oldies but Goodies

<table>
<thead>
<tr>
<th><strong>Type of business:</strong></th>
<th>Selling used CDs, DVDs, videos, and video games</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Location:</strong></td>
<td>Millerton Flea Market</td>
</tr>
<tr>
<td><strong>Target customers:</strong></td>
<td>All ages, but mainly ages 10 to 35 for the CDs, DVDs, and videos; and ages 10 to 25 for the video games</td>
</tr>
<tr>
<td><strong>Potential number of customers:</strong></td>
<td>About 300 to 800 people visit the flea market each day, which is open Fridays through Sundays.</td>
</tr>
<tr>
<td><strong>Competition:</strong></td>
<td>No one has been selling these products at the flea market since the Albertsons moved away.</td>
</tr>
<tr>
<td><strong>Other competition:</strong></td>
<td>The nearest place to buy used CDs is about 10 miles away; three local video stores sell used DVDs, videos, and video games.</td>
</tr>
<tr>
<td><strong>Challenges:</strong></td>
<td>Getting enough products to sell: Jaimie McKerry buys surplus stock for Franklin’s Discounts, and he will sell me used CDs for about $2.50 each if I buy at least 100 at a time.</td>
</tr>
<tr>
<td><strong>Costs:</strong></td>
<td>Purchasing the products, Dad will share expenses with me for renting the table ($50 for the weekend), and gas for when we go look at garage sales.</td>
</tr>
<tr>
<td><strong>Potential profit:</strong></td>
<td>I used to look at all the DVDs, CDs, and videos when Vin Albertson had his table, and he seemed to move a lot of merchandise. I think I can make a profit of $3 a unit and sell 30 to 50 units a weekend.</td>
</tr>
<tr>
<td><strong>Background and special skills:</strong></td>
<td>I have been going to garage sales with Dad for several years. There are always old DVDs, CDs, videos, and video games that I can pick up at low prices. I like negotiating when I buy and sell, and I like helping Dad at his table. I also know popular titles.</td>
</tr>
</tbody>
</table>

### Prepare a Plan

Select a merchandising business that you think you would like to own. On a separate sheet of paper, describe the type of business, the product(s) involved, and the factors you think would make it successful. Explain why you think you could make this business a success.