Unit 5: Chapter 15

BUSINESS START-UP

Learning Outcomes from this chapter

On completion, you should be able to:

- Identify and explain the elements involved in a new business start-up
- List the main sources of finance available for business start-up
- Identify the elements of production processes
- Illustrate the central role of the business plan for various stakeholders
- Calculate the break-even point from forecasted sales and costs figures
- Analyse the uses and limitations of break-even analysis

Challenges when starting a new business

Long-term finance	Attracting investment, balancing sources – not taking on too much debt (repayments), not giving away too much equity (loss of control)
Working capital	Having enough cash to meet day-to-day expenses (cash flow)
Production method	Choosing job, batch or mass (depending on USP, customer, price)
Ownership structure	Choosing suitable structure: sole trader, partnership or limited company
Marketing	Conducting research to know where to advertise, cost of sales promotions, how to use social media and public relations for publicity
Market research	Finding useful, up-to-date research, conduct field research (takes time and money)
Creating a USP	Developing features/functions to stand out from competitors and existing products
Location	Cost of buying/leasing shops or premises (the right place for the target market)
Staff	Availability/cost of staff, interviewing, employment legislation, tax

Production options: job, batch or mass

Type	Explanation	Features of process
Job	Specific product made to meet a consumer's needs, e.g. a wedding dress	Specialised/expensive labour, flexible machinery, premium price, slow process
Batch	Production of a limited quantity of identical products, e.g. a batch of Maths books	One batch at a time (same size, shape, colour), semi-skilled labour, made for stock
Mass (flow)	Continuous production of the same item, e.g. toilet paper, biros	Items used up regularly, lower labour needs, highly automated, made for stock

Business plan

Business details	Outlines the objective for the business (mission statement), vision, location and ownership type (e.g. partnership or limited company)
Market analysis	Research on the size of the market, different segments and characteristics of the chosen target market
Marketing plan	**4 Ps** for a good/service: • **Product:** USP, branding • **Place:** channel of distribution • **Price:** strategy (e.g. premium, penetration) • **Promotion:** advertising, sales promotion
Production plan	Time/labour/materials/machinery required for production (per unit) Production process: job/batch/mass
Financial plan	Cash flow forecast, long-term finance (debt/equity), break-even analysis

Importance of a business plan for an entrepreneur

Focus on the future	Prepare for the future, provide a map/guide
Anticipate problems	Proactive contingency plan for foreseeable problems
Attract investors	Use business plan as sales pitch, highlight the potential of the business
Act as a means of control	Compare plan to actual performance, take corrective action

Uses of the business plan for various stakeholders

Employees	Understand business better and assess job security
Shareholders	Projected sales/profits help calculate return on investment (ROI) vs risk
Financial institutions	Sales projections; cash flow forecast shows ability to repay loans
Management/employers	Compare plan against actual, take corrective action, request a bonus
Suppliers	Assess creditworthiness of the business before deciding to sell on credit
State agencies	Local Enterprise Offices (LEOs) and Enterprise Ireland assess businesses before offering grants/subsidies

Break-even analysis

Fixed costs	Costs that remain the same irrespective of the level of output	Rent, loan repayments
Variable costs	Costs that change as the level of output changes	Direct wages
Contribution per unit	How much each unit sold will make, after deducting the cost of manufacturing	Selling price **–** variable cost per unit
Break-even amount	The number of units a business needs to sell to cover total costs	Fixed costs **÷** contribution per unit
Profit at full capacity	How much profit the business plans to make if it successfully sells the target output	Total revenue **–** total costs
Total revenue	The sum raised from selling goods	Selling price **×** output
Total costs	The sum of all the costs of production	Fixed costs **+** variable costs
Margin of safety	How far forecasted sales can fall before the business becomes lossmaking	Forecast output **–** break-even amount (in units)

Steps in drawing a break-even chart

1

Step 1: Draw and label the axes.

2

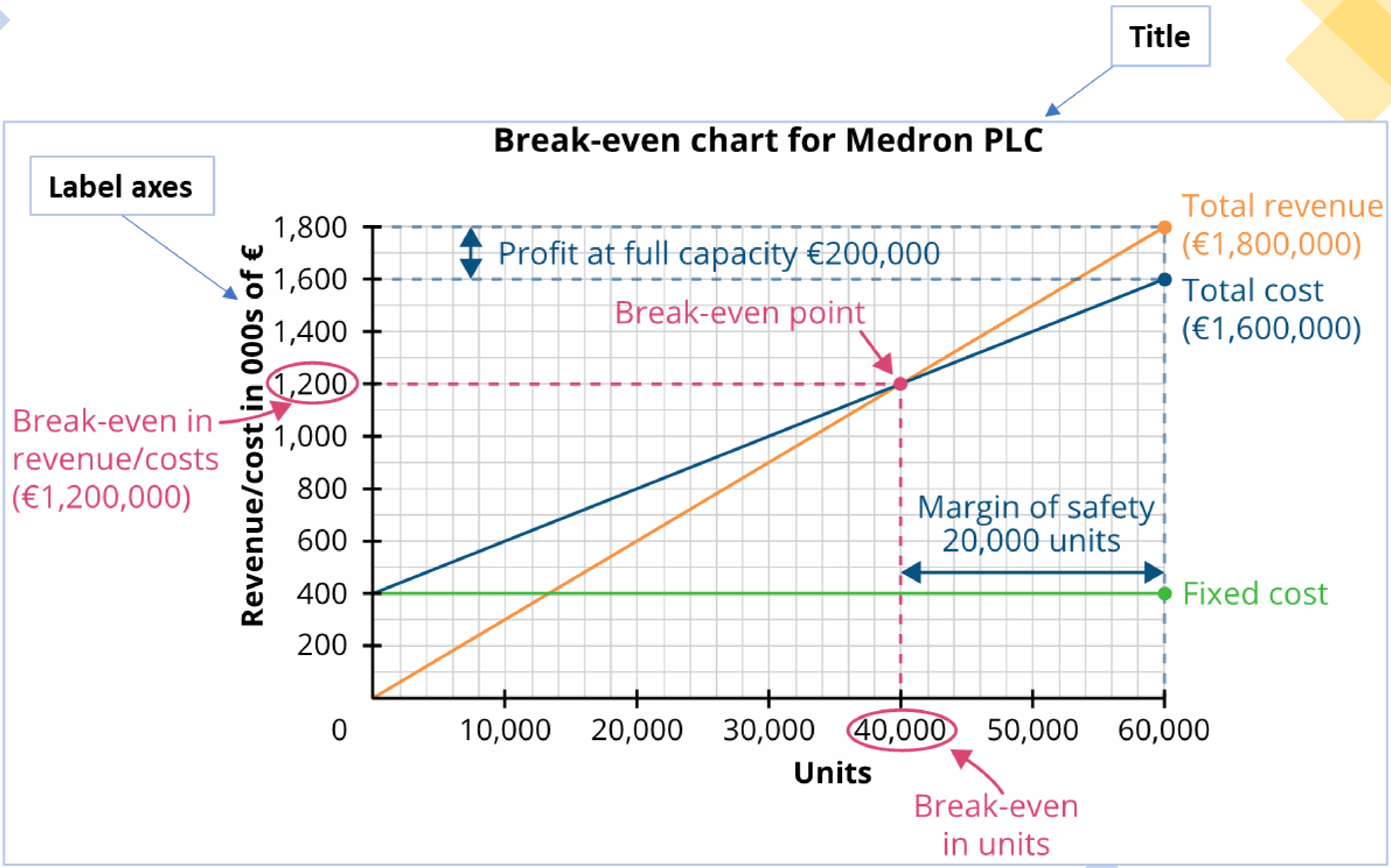
Step 2: Add lines for total revenue, total cost, fixed cost.

3

Step 3: Show the break-even point, break-even revenue/cost and break-even units.

4

Step 4: Highlight the margin of safety and profit at full capacity.



Title
Label axes
Break-even chart for Medron PLC
Revenue/cost in 000s of €
1,800
1,600
1,400
1,200
1,000
800
600
400
200
0
10,000
20,000
30,000
40,000
50,000
60,000
Units
Profit at full capacity €200,000
Total revenue (€1,800,000)
Total cost (€1,600,000)
Break-even point
Break-even in revenue/costs (€1,200,000)
Margin of safety 20,000 units
Fixed cost
Break-even in units

Break-even analysis (benefits/limitations)

- **Benefits**
- Shows forecasted profits at different sales levels
- Shows the size of the safety net if sales don't meet targets (margin of safety)

- **Limitations**
- Prices may have to be lowered to sell more units, as it will help increase the demand, and the break-even analysis shows the projections based on the selling price remaining consistent.
- Variable costs might decrease when buying in bulk so won't be constant over all quantities. A break-even analysis is based on variable costs remaining the same at all levels of output.
- Does not factor in any sales that are returned by consumers (e.g. faulty goods).