

**Micro businesses are very small companies** run by their owners with few employees. They are often home-based, with annual sales under \$250,000 and few assets, but they can qualify for loans to help them grow into large regional, national or franchise businesses.

Pursuits that have led to successful micro businesses include cooking, child care, housecleaning, sewing, photography, errand-running, computer services, bicycle repair and medical records transcription.

**Many micro businesses start with a hobby or a great idea.** But to succeed you need more than that—you need the background and expertise to help your business thrive, the money to enable your company to survive during the early stages and an honest evaluation of your business skills.

The Small Business Administration (SBA) says that more than half of small businesses fail in their first year. Many businesses fail because they lack adequate funding. If you don't have the money, you may be able to borrow it. To be considered for a business loan you must have good credit and the ability to repay the debt. Larger loans often require collateral as well. A business is a big commitment—you can prepare by saving money in advance or by keeping your current job while launching your start-up.

Business can be risky. You could lose your own money as well as borrowed funds. You remain responsible for your loans until they are fully paid off, even if your business closes. Even success has its challenges—it takes long hours and hard work to ensure a thriving business.

## Anticipating your business needs

Sound financial planning is key to a successful business. Predicting what it will cost to run your company will help you to prepare a budget that closely reflects your business plan.

**Many small business owners mix personal finances with business finances—it is best to keep them separate.** Set up a business checking account and apply for credit cards in the name of your business. Compare rates on business credit cards and business checking accounts at three or more banks.

The Internal Revenue Service (IRS) advises keeping business and personal accounts separate. “Co-mingling” personal and business transactions makes it hard to track business activity and might raise questions about whether your deductions are allowable.

### Micro business ‘to do’ list

- ❖ Research your industry.
- ❖ Find a market with room for your business to grow.
- ❖ Develop a sound business plan.
- ❖ Seek advice from knowledgeable sources.
- ❖ Network in the community and in your industry.
- ❖ Make sure your advertising reaches the right people.
- ❖ Delegate tasks you don't do well.
- ❖ Add a safety margin to all estimates.
- ❖ Run credit checks before you extend credit to customers.
- ❖ Reassess your business needs on a regular basis.

Paying for business purchases on a credit card can help manage cash flow by giving you extra time to pay. Some cards give you “perks” such as discounts and rebates. Many micro business owners rely on personal or business credit cards to pay for some purchases and track expenditures. But using credit card cash advances to pay for business expenses can result in large balances that are difficult to repay.

### Before you start a business, think about these important questions:

- ❖ **Define your vision:** Is your idea feasible? Do you have the experience and background to make your idea flourish? Is this a business with little or no competition in which you have a good chance of success?
- ❖ **Analyze your competition:** Are there too many companies in this line of business? If you want to open a dry cleaning business with five competitors nearby, consider a different neighborhood or a different idea.
- ❖ **Identify potential customers:** Is there demand for your product or service?
- ❖ **Develop plans to attract customers:** How will you let people know you are in business? Consider paid advertising, flyers and free publicity in the local media.
- ❖ **Self-analysis:** Are you really the kind of person who can be your own boss? Some people are better off as employees rather than as business owners.

## Business planning and bookkeeping

Your business plan is like a resume for your business, an essential written document that describes your concept, outlines your objectives, forecasts costs and details the strategies you will take to achieve your goals. You will need it when you approach lenders and partners. Community groups offer free or low-cost classes on writing a business plan and many websites offer free business plan templates.

A well-rounded business plan includes an overview of your business purpose plus information about your products or services. It outlines your company's structure and organization—a sole proprietorship or partnership, for example—and includes short biographies of key personnel. In it, you provide figures to support the need for your business, outline strategies for reaching customers and detail the costs of running your business now and in the future.

## The financial documents you need for your business plan include:

- ❖ **Profit and loss (or income) statement.** This is a financial report that summarizes revenues and expenses every three months (quarterly) and annually (each year). It shows your “net income”—the amount you have left after all expenses are subtracted from revenues.
- ❖ **Balance sheet.** This financial report shows what you own and what you owe—the difference is the value of your company.
- ❖ **Cash flow forecast.** This report helps you calculate future expenses to make sure you have money to pay your bills. A successful business must have a good “cash flow” (sometimes called “working capital”) from sales and receipts. Forecasting estimates the cash that will flow in and out of your business over time, including sales, supply costs, payroll and taxes.

**Accurate bookkeeping is essential.** Your books should include receipts and records of every sale, payment and expenditure. By keeping accurate books you can closely monitor your profits and the value of your business. On a daily or weekly basis, transfer sales and receipts to a ledger—a book or computer program used to track money taken in and paid out by your business.

## Your business structure

Sole proprietorships (one-person businesses) or partnerships between two or more owners are the easiest and least costly ways to set up—or “structure”—a business. Owners have authority over all business decisions but they must report business income and losses on their personal tax returns and are personally liable for all business-related debts. If your business fails, you may have to file personal bankruptcy. If you abandon debts or file bankruptcy, your personal credit history will be damaged.

Consider forming a limited liability company (LLC) or corporation if your business puts you at risk of being sued by customers or if you have substantial personal assets to protect should your business fail. Lawyers charge about \$1,500–\$2,000 for this work.

### LLC advantages:

- ❖ Fewer legal requirements than incorporation.
- ❖ Allows multiple owners or one owner.
- ❖ Protection of personal assets and protection from personal liability.
- ❖ Favorable tax treatment of profits.

### LLC disadvantages:

- ❖ More legal requirements than sole ownership or partnership.
- ❖ May not protect your personal assets.

- ❖ Legal or tax counsel is needed to prepare LLC documents.
- ❖ LLC owners must regularly file a renewal or similar required document with the state (frequency, cost, etc. are determined by the laws of the state where the LLC is registered).

## Start-up costs

Many small companies are started with the founder's personal savings. Start-up funding should cover operating expenses for at least one year. For help with estimates of business costs, consult the Small Business Administration or SCORE. (*See “Free resources.”*) In estimating costs, make sure you include:

- ❖ Your salary needs: If you are leaving a salaried job to start a business, include money to live on.
- ❖ Start-up costs: Equipment, installations, remodeling, utility deposits, licenses and professional and legal fees.
- ❖ Direct costs: Raw materials or inventory.
- ❖ Overhead: Rent, maintenance, supplies and utilities.
- ❖ Recurring costs: Salaries, insurance, interest payments, payroll taxes and advertising and promotion.

## Finding funds for your business

- ❖ **Use your own money.** If you don't have cash to invest, consider selling possessions to raise money. Most lenders want to see that you are risking your own money before asking for a loan.
- ❖ **Form a partnership** with an individual who has money to invest in your business, such as a retired businessperson or a friend or family member.
- ❖ **Apply for a Small Business Administration loan.** (*For more information, see “SBA loans.”*)
- ❖ **Line of credit.** A business “line of credit” helps you meet temporary, short-term cash flow needs. If your first application is turned down, don't give up. When you apply for a loan, be prepared to answer tough questions about your business. You may have to create a “loan package” with several funding sources.
- ❖ **Business credit cards.** If used carefully, a business credit card can help you manage cash flow and keep your business obligations separate from your personal obligations. Business cardholders can earn discounts on supplies, rental cars and other services. In most cases you must accept personal liability for the charges on a business card. Payments and balances on your business credit card show up on your personal credit reports, so late payments or large balances could hurt your credit score. To build a business credit history, register with major business credit bureaus such as Dun & Bradstreet and Business Credit USA.

❖ **Commercial finance companies.** In most cases, rates on finance company loans will be much higher than bank loans.

❖ **Life insurance.** If you have whole life insurance with substantial cash value, you can ask for a policy loan. Many companies lend up to 90% of the cash value of the policy.

❖ **Lease equipment instead of buying it.** When you lease you don't tie up large amounts of cash. Equipment leases may cover maintenance and repairs.

❖ **Barter—or exchange—property or services.** If you are a painting contractor, you could paint the local newspaper's office in exchange for advertising space.

#### Top five micro business mistakes

- ❖ Inadequate planning
- ❖ Failure to discipline yourself financially
- ❖ Insufficient cash reserves to sustain growth
- ❖ Poor recordkeeping
- ❖ Excessive debt

## SBA loans

The U.S. Small Business Administration (SBA) has programs and services available to help micro businesses succeed. These include the counseling and training services of SCORE (formerly known as the Service Corps of Retired Executives) and financial assistance from the Microloan and 7(a) loan programs. The SBA can help you prepare loan documents and it also guarantees loans. You pay for these services through fees when your loan is approved. The SBA sets the maximum rate banks may charge. In qualifying applicants, lenders consider the cash flow generated by the business, the experience of the business owners and the downpayment or collateral offered by the borrowers.

The SBA sponsors several lending programs, including a loan guaranty program for start-ups and small businesses; building and renovation loans; loan preapproval services, and small-scale financing and technical assistance for start-ups through SBA-funded nonprofit business development programs. The SBA also helps minority and economically disadvantaged owners contract with the federal government.

The SBA Microloan Program provides loans up to \$50,000 to help small businesses and certain not-for-profit childcare centers start up and expand. The SBA 7(a) Loan Program guarantees loans up to \$5 million to small businesses for a variety of uses; the SBA does not set a minimum loan amount. The funds for these loan programs are made available through third-party nonprofit community-based organizations and SBA-approved lenders. Each lender sets its own lending and credit requirements. In some cases, borrowers must fulfill training and planning requirements before having their loan application considered. (If your business fails, you will still be responsible for your loans.)

Among its many services, the SBA helps streamline the lending process with lower downpayments, longer terms and lower interest rates than conventional loans. Most owner-operated businesses are eligible to apply for SBA loans.

#### The basic steps to getting an SBA loan:

- ❖ Use the SBA's online "Loans and Grants Search Tool" ([www.sba.gov/loans-and-grants](http://www.sba.gov/loans-and-grants)) to find out which loan and grant programs you might qualify for.
- ❖ If you qualify for a loan program, do a lender search at SBA.gov. Call around or visit the lenders' websites to compare terms and borrower requirements.
- ❖ Decide which lender you will apply to. Compile the financial and business records required by the bank.

#### Key questions to answer when applying for an SBA loan:

- ❖ Can your business repay the loan out of its cash flow?
- ❖ Do you have a good personal credit history?
- ❖ Do you collect money from people who owe you in a timely manner?
- ❖ Do you have a profitable history?
- ❖ Are your sales growing?
- ❖ Is the future of your industry bright?
- ❖ How are you positioned against competition?

## Your legal and professional needs

Most businesspeople need professional advice. There are many free resources available through the SBA and other organizations, but you may need advice that is specific to your situation. Always compare fees and check references before hiring a professional.

If you are in the start-up phase, you may find professional help for less money by joining a business "incubator" (see "Free resources"). Incubators are organizations that help new businesses in various ways—they may offer mentoring services, small business assistance programs and management training programs, or provide office space and economic development funding.

#### You must comply with local, state and federal regulations.

Requirements vary by business and by state. The SBA or your local Chamber of Commerce or office of economic development can help you learn about requirements.

Check with your city or county tax collector and zoning authority about business licenses, building permits and requirements for your industry. On the state level, you will need a sales permit, sales and income tax documentation and any licenses required by your state, as well as workers' compensation insurance for your employees.

On the federal level, you are responsible for verifying your employees' right to work in the U.S., withholding employee income taxes and complying with minimum wage, overtime and child labor laws. You will be required to make estimated income tax payments for yourself and pay Social Security and Medicare taxes for yourself and your employees.

## Free resources

- ❖ **The Association for Enterprise Opportunity** ([www.microenterpriseworks.org](http://www.microenterpriseworks.org)) lists its member micronenterprise development programs.
- ❖ **The Better Business Bureau** ([www.bbb.org/us/business](http://www.bbb.org/us/business)) provides information about ethical business conduct, standards for advertising and how to protect against fraud.
- ❖ **Entrepreneur.com** ([www.entrepreneur.com](http://www.entrepreneur.com)) offers tips and how-to guides on all aspects of going into business.
- ❖ **The National Business Incubation Association (NBIA)** ([www.nbia.org](http://www.nbia.org)) advances business incubation and entrepreneurship.
- ❖ **SCORE** ([www.score.org/800-634-0245](http://www.score.org/800-634-0245)) is a national organization offers free and confidential small business advice from volunteer mentors.
- ❖ **The U.S. Chamber of Commerce** ([www.uschamber.com](http://www.uschamber.com)) offers an online directory of nationwide Chambers of Commerce and a "small business toolkit."
- ❖ **The U.S. Small Business Administration** ([www.sba.gov/800-827-5722](http://www.sba.gov/800-827-5722)) provides a wealth of free resources and services for micro business owners.

#### Consumer Action

[www.consumer-action.org](http://www.consumer-action.org)

Contact our Hotline:

[www.consumer-action.org/hotline/complaint\\_form](http://www.consumer-action.org/hotline/complaint_form)

415-777-9635

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# Micro BUSINESS

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