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Starting a Home-Based Business

Michigan State University Extension Service

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# Starting a Home-based Business



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EXTENSION

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# Planning



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# Home-based Business – Planning

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The home is an excellent place to start a business. Being clear about your reasons for starting a home-based business will help you make better business decisions. As you start the planning process, you may wonder why you need to answer so many questions. Starting a business is an important step, and thinking, planning and analyzing in the beginning can save much time and worry later.

## Why are you starting a home-based business?

You may:

- Have a part-time hobby you want to turn into a business.
- Want to work at home for convenience or personal reasons.
- Be unable to afford an office or shop at this time and want first to try a business idea from home.

Your success often hinges on your motivation and the reason for starting the business.

Some common reasons include:

- Desire to be your own boss.
- Financial independence.
- Interest in spending time with or being in the same place as your family.
- A chance to build on a hobby or interest.
- Desire for creative freedom.

Many people have difficulty deciding what kind of business is best for them. They have several ideas and find it difficult to narrow them down.

Why are you thinking about starting a home-based business?

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## What kind of business is right for you?

Think of the experiences you have had, starting with school. Note how they have changed or remained the same.

What are your hobbies? Interests?

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What kind of educational experiences have you had, formal or informal?

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What have your job experiences been?

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What do you want for your lifestyle? Money?  
Family life? Personal goals?

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What volunteer or community work have you enjoyed?

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What do you value about your current lifestyle?

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Which of the above did you enjoy the most?

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What would you have to give up or change to give that time and commitment to a business?

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What environment did you enjoy the best?  
Inside, outside; with people, alone; in the city,  
in the country?

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What things do you want to be a part of your future lifestyle that aren't on your present list?

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Will opening your own business help you attain those things?

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Now that you have looked at your past experiences, likes and dislikes, choose two or three possibilities for your business from your experience or the following list. Then think about yourself as having that business and try to think of all the advantages and disadvantages.

Business #1 \_\_\_\_\_

Advantages \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Disadvantages \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Business #2 \_\_\_\_\_

Advantages \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Disadvantages \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

*Note:* Keep in mind that it is not always the length of the list for each category but the value you place on each item that is critical. If you have listed only three advantages for a particular business but they are so important that they outweigh the six disadvantages, that may be the business for you. Be sure to be realistic when evaluating your choices.

## Some possible home-based businesses

- Printing service
- Typing service — manuscripts
- Telephone dictating
- Telephone answering service
- Wake-up service
- Resume' service
- Freelance writing/editing
- Calligraphy
- Phone service for shut-ins
- Genealogical research
- Bookkeeping service
- Cleaning (home or business)
- Laundry service
- Housesitting (walk dog, tend plants, etc.)
- Plant care (home or business)
- Garden service (yard or balcony)
- Landscape planning
- Lawn care and/or snow removal
- Growing herbs, drying and selling
- Babysitting coordinator

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- Family day care
- After-school child watch
- Day care for older persons
- Car pool coordinator
- Image consultant (select clothes for busy people)
- Sewing (includes new construction)
- Alterations (only alterations)
- Custom draperies and window treatments
- Chair caning
- Upholstery and slipcovers
- Furniture refinishing
- Wallpaper hanging
- Interior design
- Interior and exterior painting
- Painting wall murals
- Antique dealer and appraiser
- Builder's clean-up service
- Catering
- Pastry chef to local restaurants
- Candy making
- Service coordinator (locate and schedule plumbers, repair people, etc.)
- Organization consultant (assist organizations in strategic planning)
- Party planner
- Clown for rent
- Bridal consultant
- Errand service
- Shopping service
- Bed and breakfast
- Grocery shopping service
- Gift wrapping
- Garage sale consultant
- Attic and cellar cleaning
- Car or truck washing
- Chimney cleaning
- Auto body repair
- Auto tune-ups
- Home fix-it service
- Small engine repair
- Lawn mower sharpening
- Screen and storm window service
- Bicycle repair
- Pool cleaning and maintenance
- Dog boarding and grooming
- Doghouse building
- Picture framing
- Clock repair
- Cordwood supplier
- Amusement director
- Photographer
- Fish tank cleaning and maintenance (home or business)
- Freelance bartending
- Sealing driveways
- Trailer and camper maintenance and repair
- Underground sprinkler system installation
- Bait shop
- Taxidermy
- Dock building and maintenance
- Teaching - Dancing
- Piano
- Sewing

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- Gourmet cooking
- Art
- Crafts - needlepoint, knitting, etc.
- Photography
- Foreign language
- Artisans - Weaving
- Needlepoint
- Quilting
- Ceramics
- Woodworking
- Stained glass
- Dough ornaments
- Apple dolls
- Batik
- Driftwood
- Dry flowers
- Pottery
- Chair caning
- Leathercraft
- Candle making
- Doll making
- Silk flower designs
- "I'll finish your project" service

- Self-discipline
- Creativity
- Organization
- Enthusiasm
- High need for achievement
- Ability to set goals
- Ability to solve problems
- Independence
- Self-confidence
- Energy
- Willingness to take calculated risks
- Willingness to take responsibility for self
- Strong desire to WIN
- Motivation
- Good health
- Persistence
- Other (explain)

## *Life experiences:*

Check the experiences you have had. (If you have not worked at a paid job, include those from running a home or volunteer work.)

- Budgeting
- Selling
- Organizing
- Problem solving
- Delegating
- Raising money
- Advertising
- Buying
- Planning
- Shipping/delivery

## Resources

### *Do you have what it takes?*

Personal inventory checklist

Check the characteristics you think you have.

- Skills and knowledge in your field
- Determination

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- Directing
- Communicating
- Coordinating
- Keeping books
- Evaluating
- Goal setting
- Presenting
- Other (explain) \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

## Commitment:

How much time can you give to your business? \_\_\_\_\_

What priorities do you have in your life right now? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

A job? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Your family? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Outside activities? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Other special circumstances? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

How much time will these priorities take?

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

## Here are some other questions you need to ask yourself:

- Do you have the energy to work long hours?
- Will you be able to say “no” to leisure or family activities? Will family members understand?
- Will you be able to have a personal and family life and run a business?
- Are you able to budget expenses and stick to the limits you set?
- Do you understand the importance of business records? Will you be able to keep up-to-date records of inventory, financial transactions (purchases and sales) and contacts?
- Do you have other sources of income until the business is established?
- If the business fails, will your home life remain stable?
- How long do you think it will take to become successful? Do you believe this is realistic?
- Do you have the knowledge about a particular business to make it a success, or do you need more time to learn?
- Will you be able to set and keep high standards for your product or service?

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- What are your community contacts? What kind do you have and what kind do you need?
- Who are the people you will turn to for advice?

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## Rating scale for personal traits important to a business proprietor

*Instructions:* After each question, place a checkmark on the line at the point closest to your answer. The checkmark need not be placed directly over one of the suggested answers because your rating may lie somewhere between two answers. Be honest with yourself.

*Are you a self-starter?*

---

I do things my own way.  
Nobody needs to tell me to  
get going.

If someone gets me started,  
I keep going all right.

Easy does it. I don't  
put myself out until  
I have to.

*How do you feel about other people?*

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I like people. I can get  
along with just about  
anybody.

I have plenty of friends.  
I don't need anyone else.

Most people bug me.

*Can you lead others?*

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I can get most people to  
go along without  
much difficulty.

I can get people to do  
things if I drive them.

I let someone else  
get things moving.

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## Can you take responsibility?

I like to take charge and see things through.

I'll take over if I have to, but I'd rather let someone else be responsible.

There's always some eager beaver around wanting to show off. I say, let him.

## How good an organizer are you?

I like to have a plan before I start. I'm usually the one to get things lined up.

I do all right unless things get too goofed up. Then I cop out.

I just take things as they come.

## How good a worker are you?

I can keep going as long as necessary. I don't mind working hard.

I'll work hard for a while but when I've had enough, that's it.

I can't see that hard work gets you anywhere.

## Can you make decisions?

I can make up my mind in a hurry, if necessary. My decision is usually OK.

I can if I have plenty of time. If I have to make up my mind fast, I usually regret it.

I don't like to be the one who decides things. I'd blow it.

## Can people trust what you say?

They sure can. I don't say things I don't mean.

I try to be on the level, but sometimes I just say what's easiest.

What's the sweat if the other fellow doesn't know the difference?



# Home-based Business – *Planning*

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## *Can you stick with it?*

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If I make up my mind to do something, I don't let anything stop me.

I usually finish what I start.

If a job doesn't go right, I turn off. Why beat your brains out?

## *How good is your health?*

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I never run down.

I have enough energy for things I want to do.

I run out of juice sooner than most of my friends seem to.

Source: SBA's *Starting & Managing Series, Vol. 1, 3rd edition. "Starting & Managing a Small Business of Your Own."*





## Human resources: vital to home-based business

Analyze your situation using the following process. It examines the potential returns or future benefits compared with the cost of the investment in time or money.

Resource	Potential return	Cost to you (time and money)	Potential payoff– worthwhile?
----------	------------------	---------------------------------	----------------------------------

### *Time*

#### A. ANALYZE YOUR CURRENT USE OF TIME.

Make a daily schedule.  
Make a checklist as part of the schedule.

Establish work hours.  
Minimize interruptions.

#### B. GET CONTROL OF TIME.

Block your time. What time of day is best for your most demanding and productive tasks? An hour of time without any interruptions is more beneficial than two hours of short time segments. Block work requires almost constant attention, and family activities may need to be postponed.

Better work schedule.  
Higher quality work–  
fewer mistakes.

Organize and adopt a system or schedule best suited to your personality, such as difficult tasks early in the day. Let customers know your work schedule and business hours.

#### C. ANALYZE AND ORGANIZE TASKS.

Know the tasks to be accomplished. Consider making a daily “to do” list. It is best to make your list at the end of one day for the following day.

Setting priorities is part of both time management and planning.

More professional,  
more productive.

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## Human resources: vital to home-based business (continued)

Analyze your situation using the following process. It examines the potential returns or future benefits compared with the cost of the investment in time or money.

Resource	Potential return	Cost to you (time and money)	Potential payoff— worthwhile?
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### D. USE SPACE TO CONTROL TIME AND EFFORT.

Most people can work more efficiently in a place with some order. If you find yourself continually looking for things, it is a clue to do some reorganizing. Store things where you use them.

Design your work area to be convenient.

Consider a location that will provide privacy for customers if they come to your home. Basement or second floor areas result in extra steps but provide more privacy and freedom from interruption. A desk or table with chairs where you can confer with customers gives an appearance of organization and professionalism.

Makes work flow smoother. Reduces stress fatigue.

### E. FIT TIME USE TO GOALS.

Some home-based businesses permit greater control over time scheduling of productive activities. Others are strongly influenced by seasons and time. But all have deadlines.

A major challenge for many custom services is managing time. A hobby is done off and on or when time is available — business is done on a regular basis.



## Human resources: vital to home-based business (continued)

Analyze your situation using the following process. It examines the potential returns or future benefits compared with the cost of the investment in time or money.

Resource	Potential return	Cost to you (time and money)	Potential payoff- worthwhile?
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A few tips:

1. Keep work areas relatively neat and put equipment where it belongs.
2. Keep equipment in good working order. Good equipment that works properly saves time and makes the job easier.

### F. DELEGATE.

Ask a family member or friend to help if he or she has the skills. If your workload is heavy, try the assembly line approach to projects.

## *Personal energy*

Individuals involved in a home-based business need to have the capacity for hard work.

### A. MEETING DEMANDS.

Most people experience ups and downs in their energy level throughout the day. Recognize your prime time and plan to accomplish your most difficult tasks at that time. You are more likely to concentrate harder and finish the task quicker than at any other point in the day.

### B. GOOD HEALTH.

Good health equals more energy. Remember to include well balanced meals and exercise in your daily schedule. Don't run yourself short of fuel.

# Home-based Business – Planning

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## Human resources: vital to home-based business (continued)

Analyze your situation using the following process. It examines the potential returns or future benefits compared with the cost of the investment in time or money.

Resource	Potential return	Cost to you (time and money)	Potential payoff– worthwhile?
----------	------------------	---------------------------------	----------------------------------

Establish regular work hours with lunch and coffee breaks.

### C. BALANCING ENERGY BETWEEN WORK AND FAMILY.

Provide time for yourself and your family. If you have children, be sure to allow time in your schedule for interruptions and other family responsibilities.

## Skills

Without skills and talent, a home-based business is like a house without a foundation.

### A. REACHING YOUR POTENTIAL BY DEVELOPING EXPERTISE IN NEW PRODUCTS/SERVICES.

### B. TRAINING OR RETRAINING.

Keep up to date by reading books and trade magazines. Attend workshops and refresher courses.

Learning new techniques and approaches helps you, your customers and your business.

Adapted from: Walker, Katey, and Marilyn Stryker. 1985. "Human Resources - Vital to the Home-based Business."



## At home with business

Assessing the effect of a home business takes an understanding of:

- Your product, whether goods or services.
- The nature of contact with the clientele.
- Current patterns of family life.

Without knowledge of your product, customer-business interaction and family functioning, the best information on how to run a business may produce income but at the cost of family conflict.

After you have explored the mechanics of providing the good or service — how to design, make and market your product — think about the following.

1. What will having materials or inventory around the house mean to your family environment? For example, if you clean houses, do you have a safe place to store caustic chemicals out of the reach of your 4-year-old?
2. Can you keep business records orderly and confidential without taking up necessary family living space or rushing to hide accounts receivable from a curious neighbor?
3. Does your child mind sharing a bedroom with raw materials and finished items for your mail-order business?
4. Are customers coming to your home likely to catch someone in his/her bathrobe or interrupt your favorite TV program?
5. Will teen-agers' telephone use make it difficult for clients to place orders?

Few people analyze how the business will affect their family. Their family works well as a unit, so they seldom examine when they have the right amount of time together and apart, how much necessary household work there is and who does it, how they feel about information gathering and sharing work, or whether they understand the economics of running a business. But all these questions may come up and affect various aspects of family life:

1. Personal and family time schedules.
2. Use of space for running the business.
3. Family feelings about a home business.
4. Interaction with neighbors and friends.

### *Personal and family schedules*

Family time schedules are very dependent on where members of the family have to be at various times. At some ages, children are independent and need little driving by a parent, whereas younger children may need to be chauffeured here and there.

If family members' schedules are not flexible and independent, a business in this family will probably have to accommodate the family time schedule. Thus it would be difficult to have a retail operation such as selling maple syrup or quilts from the home that invited customers to stop in anytime. On the other hand, if the family has young children who require stand-by care and occasional full attention, such a business could bring in money and much desired adult interaction.

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## How will your business affect your family time schedule?

Daytime \_\_\_\_\_

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Evenings \_\_\_\_\_

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Weekends \_\_\_\_\_

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## Use of space in the home

Assuming your home is large enough for the business of your choice, the arrangement of space makes a difference in family activities.

Does your business require:

Storage space                      Yes      No

An area for you and customers to meet                      Yes      No

Space for tools and equipment      Yes      No

Convenient access to pickup and delivery                      Yes      No

Confidentiality in your meetings with clients                      Yes      No

Often the area of your house most convenient for customer interaction and pickup and delivery is the living room or den, while the best storage and most private sectors of the house are relatively inaccessible.

If you run your business from the room with the best access, will family members, friends and neighbors intrude on the business?

Yes      No

Can you maintain the space separations necessary for potential tax deductions as a business expense? Or does this part of the house have too many uses that are a part of the pattern of your family's life?

Yes      No

If you put business activities in a more private section — e.g., the basement or a spare bedroom — will family members feel customers are intruding on their space?

Yes      No

Will you have new or different concerns about how well and how often children clean their rooms?

Yes      No

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## Family space and time intrusion

Space codes:	Time codes:
1. Primary space — Intimate, not open to others	a. Anytime
2. Secondary space — OK if person is invited	b. Scheduled hours
3. Public space — open to anyone	c. No intru- sion at any time

How would your family react if you started a business in your home that involved customers or clients coming into your house?

1. To start the worksheet, list each room or area of your home in the left-hand column.
2. Across the top, list each family member.
3. Then in each square, "vote" for the family members (or have them vote) on how comfortable they might be with the intrusion of customers/clients into that space of the home.
4. Each area or room should be coded with a space and time code for each family member. For example, your daughter may feel that the living room is public space (space code 3) but would be happy only with scheduled hours for customers (time code b).

Home room/areas	Family members by name			
(e.g., living room, sunporch, basement, family room, bedroom)				

When this chart is finished, what spaces appear to be acceptable to your family for customer intrusion, and on what kind of a schedule?

What decisions does this suggest about how to manage the access of customers to your space and time to satisfy your family?

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## Family feelings about business at home

Another important aspect is your family's attitude toward the business.

Risk seekers look for opportunities to be tested against the world, promote novelty and change in their lives, and trust the surrounding environment. The risk avoider wants to maintain the status quo. Such a person sees the environment at home and around the family as an environment to be protected.

### Will my family

Find a business interrupting to our family life?	Yes	No
Be concerned about the financial risk involved in operating a business?	Yes	No
Worry the business will impose on our family time?	Yes	No
Resent the hours I have to devote to the business?	Yes	No
Resent it if I need to ask for their help in some work related to the business?	Yes	No

## Friends and neighbors

A business can change the neighborhood in which it is located. A home business may not be prohibited in your neighborhood by law,

but how do your neighbors feel about it? For example, a quiet dead-end street with children playing in unfenced yards is changed immensely by a high volume sewing alterations shop. Someone who sews for others may consider fitting garments at the client's house and securing alteration business through a clothing store or dry cleaners to preserve the character of the neighborhood. Pickup and delivery for a mail-order business may bring unwanted truck traffic to some neighborhoods.

If neighbors are disenchanted with having a business on their block, include the loss of this support network in assessing the impact of the home business on your family and self. Children may lose playmates and you may lose a trusted friend's support and encouragement when you most need it.

### Will my business

Make a change in traffic in my neighborhood?	Yes	No
Make a difference in my neighbors' support of me?	Yes	No
Make a difference in my neighbors' support of my family?	Yes	No

*Adapted from: Alma Owen, University of Missouri-Lincoln, and Mary Gray, University of Missouri. 1986. "Home-based Business — Combining Work with Family."*





## What form of business organization?

Several forms of business organization exist. The three principal types are proprietorships, partnerships and corporations.

### *Sole proprietorship*

The sole proprietorship is the most common form of business organization. The owner has complete control of the business and faces unlimited liability for its debts. The profits of the business are personal income and taxed at the owner's federal income tax rate.

#### *Advantages*

- Low start-up costs
- Greatest freedom from regulation
- Owner in direct control
- Minimal working capital requirements
- Tax advantage to small owner
- All profits to owner

#### *Disadvantages*

- Unlimited liability
- Lack of continuity – business ends if proprietor dies or quits
- Difficult to raise capital

### *Partnership*

A partnership is an association of two or more people. As a form of business organization, partnerships, like proprietorships, are subject to relatively little regulation and are fairly easy to establish. In a general partnership, the partners share equally in the profits and losses. As in a sole proprietorship, the general partners have unlimited liability for the company's debts. The partners' shares of the profits are taxed as personal income.

#### *Advantages*

- Ease of formation
- Low start-up costs
- Partners provide additional sources of venture capital
- Broader management base
- Possible tax advantage
- Limited outside regulation

#### *Disadvantages*

- Unlimited liability
- Lack of continuity – business ends if proprietor dies or quits
- Divided authority
- Difficulty in raising additional capital
- Hard to find suitable partners

# Home-based Business – Planning

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## Corporation

The most complex form of business organization is the corporation. A corporation consists of three groups of people: shareholders, directors and officers. The corporation can own assets, borrow money and perform business functions without directly involving the corporation owner(s). The corporation is subject to more government regulation than proprietorships and partnerships. The profits are subject to double taxation, but liability is limited — owners are not personally responsible for debts incurred by the corporation.

### Advantages

- Limited liability
- Specialized management
- Ownership is transferrable
- Continuous existence — the business is an entity separate from the owners
- Legal entity
- Possible tax advantages
- Easier to raise capital

### Disadvantages

- Closely regulated
- Most expensive form to organize
- Charter restrictions
- Extensive record keeping necessary
- Double taxation

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Source: SBA's *Starting & Managing Series, Vol. 1, 3rd edition, "Starting & Managing a Small Business of Your Own."*

## Limited liability companies

The limited liability company (LLC) is a form of business ownership in Michigan that combines the best features of a partnership and a corporation. An LLC is like a corporation in that its owner's liability is limited to the amount of money invested in the company. An LLC is treated like a partnership for federal income tax purposes as long as it meets certain tests in the federal regulation.

This form of ownership may be an alternative for some home businesses. Public Act 23 of 1993 opened the way for this new business structure. The law is fairly new and this form of ownership is evolving, so it is most important to seek professional help in understanding the pros and cons of it. It may or may not be the best type of ownership for your home business.

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*Adapted from "Q & A: Limited Liability Companies," The WESTOPS Report, June 1993.*

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## Start-up costs

Now that you have decided on the type of business you want to start, you need to estimate the amount of money you need to begin operating. The following chart includes the most typical costs. Your particular needs may vary, so adjust the items to fit your situation.

Equipment (if you don't already own it) \$

<hr/>	<hr/>
<hr/>	<hr/>
<hr/>	<hr/>

### Licenses and fees

Register assumed name with county clerk	<hr/>
Other licenses	<hr/>
<hr/>	<hr/>
<hr/>	<hr/>

### Starting inventory

<hr/>	<hr/>
<hr/>	<hr/>
<hr/>	<hr/>

### Insurance

Additional homeowner's coverage	<hr/>
Liability	<hr/>
Other	<hr/>

### Printing

Business cards, brochure	<hr/>
Letterhead stationery	<hr/>
Sales receipts	<hr/>
Other	<hr/>

### Business banking

<hr/>
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# Home-based Business – Planning

Michigan State University Extension



## Start-up costs (continued)

	\$
Office supplies	_____
Initial advertising and promotion	_____
Legal and professional fees	
Bookkeeping	_____
Legal	_____
Other	_____
Total =	_____

## *Where will you get the money to start?*

Most home-based business owners start a business with their own funds. You will need start-up funds and also some operating funds until your business brings in income. Financial institutions are unlikely to lend to a new business, but you may get loan funds based on your personal/family assets. Some possibilities are a personal loan, a home equity loan or line of credit, or your credit card. Each of these options will have an interest cost — and some options may have additional fees.

Another option is to borrow from family or friends. If you borrow, make sure you do it on a businesslike basis — with a written agreement that stipulates payment due dates and the interest rate.



## Developing a business plan for a home-based business

Every business begins with an idea — a product to be produced or sold, or a service to be performed. In developing your business plan, you are “putting your dream on the road.” It takes time, energy and patience to draw up a satisfactory business plan.

Business plans serve three objectives:

- 1) They serve as feasibility plans or marketing plans to help you think through the venture and ensure that you have considered all your options and anticipated potential difficulties.
- 2) They serve as an operating/procedural plan for you by mapping out the first 3, 6 or 12 months' financial needs and setting production and marketing goals.
- 3) They can be used as a tool for securing loans for the business. (Remember, however, that most home-based businesses are started with funds from the owner, not funds from a financial institution.)

*This outline consolidates the individual ideas that you will compile throughout this workbook. It is designed to help you get your ideas and supporting facts on paper. As you finish each chapter, come back to this outline.*

## Business plan outline

### I. Cover.

The cover page should include the name of your business, its address, telephone number and logo, if there is one. Give your plan a businesslike appearance by typing it and putting it in a vinyl or cardstock binder or three-ring notebook.

### II. Title page.

Repeat the business name, address and phone number, and add the names, addresses and telephone numbers of the principal owners. Most home businesses are sole proprietorships (one owner). However, your business could be a partnership, a corporation or a limited liability company. Also include the date of the plan.

### III. Summary.

This is a brief (one-page) summary of the business plan purposes and objectives. Address the following questions and add any additional information that will help you achieve your goals. Be clear, concise and specific.

- A. What is the purpose of this plan? Will it be used as:
  1. An operating guide?
  2. A financial proposal?
  3. A feasibility plan?
- B. What business structure have you chosen (i.e., sole proprietorship, partnership, limited liability company, corporation)?

# Home-based Business – Planning

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- C. Who are the principals and what are their proportions of ownership?
- D. Why will the venture be successful?

For a financing proposal (optional):

- E. Who is requesting the funds and how much is needed?
- F. What will the money be used for?
- G. How will the funds be repaid?
- H. What collateral will you offer to secure the loan?
- I. Why does a loan or investment make sense? (Impact on local economy, job creation, increased tax base, investment in the future of the community, etc.)

## IV. Table of contents.

When you are looking over your plan, it is easier to locate sections of it if it has a table of contents, a single page showing major topics and page references.

## V. Description of the business.

Answer as many of the following questions as are appropriate:

- A. What business are you in?
  - 1. Type of business — retail, wholesale, service provider, manufacturing, mail order.
  - 2. What is the nature of the product(s)/ service(s)?

- 3. What amount of inventory must you keep on hand?
- 4. What will be special about your business?

## B. Why are you going to do this?

- 1. Why will this be profitable?
- 2. Why will you be better than your competition? (See D under “Market analysis and planning”.)
- 3. When do you plan to get it started? What is your target date?
- 4. List the hours and days of operation. Is this a seasonal business? If so, in which months do you anticipate your greatest sales?

*Note:* If yours will be a seasonal business, be sure the seasonality is reflected in your narrative and financial projections with appropriate footnotes.

- 5. Complete the following questions after you have completed the appropriate later sections.
  - a) Summarize the abilities you have that will make this profitable.
  - b) Summarize your experience in this line of business from your resume.
  - c) Summarize your research into this line of business.
  - d) Summarize your efforts to secure supplies, services and credit.

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- e) If you will be doing any contract work, what are the terms? Reference any firm contract and include it as a supporting document.
- C. How big will the business be in one year? 5 years? 10 years?
- D. How will you describe the business?
1. To your family?
  2. To your customers?
  3. What are/will be your special competencies?
- E. What permits, requirements and/or licenses will you be required to obtain?
1. How will you be affected by local zoning, planning regulations?
  2. Is your business name registered with your county?
  3. Will you need a tax number?
  4. Will you need a health inspection? License?
  5. Other regulations:
- F. Insurance: Describe your potential business risks and tell what insurance coverage you will purchase to protect yourself (fire, liability, worker's compensation, product liability, etc.).
- VI. Market analysis and planning.
- A market analysis begins with the question "Who is my market?" Who needs your product or service? Can you visualize your customers? Are they commercial? industrial? residential? seasonal? How do you plan to reach them?
- A. What market do you intend to serve? What is the total market? Is it all of the people in the United States? your local community?
- B. What percentage (segment) of that market is yours? Now and in the future?
- C. What is the present size and growth potential of the market? If it grows, will your share grow, too?
- D. How will you attract and keep your segment of this market?
1. Product/service quality.
  2. Price.
  3. Public relations.
  4. Personal selling.
- E. How will you price your merchandise or services?
- F. How will you service your market? Will you strive to provide better service, better products or cheaper prices? What are your plans for satisfying your market?
- G. How will you handle credit sales?
1. Extend your own credit?
  2. Accept major credit cards?
- H. Who are your target customers? Describe their age, sex, occupation, lifestyle, needs, buying habits, income, etc. Are they wealthy, poor or of middle income? Are they old or young? Look at the statistics of your market area to answer these questions.

# Home-based Business – Planning

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## I. Competition

1. Briefly describe your competition. How do you compare with them? How is their business doing? Is there room for one more business like yours? Tell how your operation is similar and dissimilar to theirs.
2. Do your competitors have any apparent advantages over you? How do you intend to overcome these advantages?
3. Is the market saturated?
4. What are your plans concerning future competitors?
5. If you plan to advertise, state what media or combination of media you will use. Discuss why you believe these methods to be the most effective and what segment of your market you expect to be able to reach with them.
6. Discuss the content of your promotion or advertising. How will you inform the market about your product/service? How will you describe it? How and what will you say about your business address, business hours and phone number? What type of image do you want your advertising to project, and why?

## J. Market plan

1. What are your market strategies? (Your product will sell because one or more of the following is attractive: the product features themselves, pricing [high, medium, low]; a convenient distribution system that works well; or successful advertising [promotion].)

2. Describe how you plan to promote your product/service. (What type of promotion will you utilize — word-of-mouth, mass media advertising, direct mail, personal contacts, trade shows, sponsorship of events or other means?)

## VII. Operations and location.

If you are like most home business owners, you'll end up doing most of the work for a while. Still, it is important for you to figure out, in advance, exactly how you are going to get everything done with the time and money you have available. Be realistic about your ability to do all the work that may be involved.

- A. Who is responsible for each part of the start-up and operation?

Name \_\_\_\_\_

Operation \_\_\_\_\_

Time needed \_\_\_\_\_

Money needed \_\_\_\_\_

- B. Who are your suppliers? (change as appropriate)

Name \_\_\_\_\_

Address \_\_\_\_\_

Products \_\_\_\_\_

Terms \_\_\_\_\_

Cost \_\_\_\_\_

Shipping time \_\_\_\_\_



# Home-based Business – Planning

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## C. Location

1. What are the physical features of your location (parking space, steps to climb, heating and cooling, waiting space and fitting space, if applicable)? Will any changes or repairs be needed? How much will they cost?
2. How much space will you need for storage? for production? for shipping, etc.?
3. If customers will come to your home, are you conveniently located? Easy for customers/suppliers to locate? Is your location conducive to drop-in customers? Will you pick up and deliver?

## VIII. Ownership and management.

To have an accurate idea of what the business must make to support itself and you, include your personal financial statements, tax returns for the past three years and a personal family budget. This is useful information that refers to your financial expectations, and it is mandatory if you are attempting to secure financing from an outside source.

- A. What is your business and management experience?
- B. What education have you had, including both formal and informal courses, that contributes to your managerial abilities?
- C. Do you have direct operational and/or managerial experience in this type of business?
- D. What other management resources will be utilized (accountant, lawyer, Small Business Development Center, etc.)?

- E. List local contacts who may assist you in your business.

## IX. Funding.

If you are seeking outside financing, you will need to describe the project to be financed, state where the money to pay for the project will come from (sources) and how it will be used (uses). The most common uses are equipment, space improvements, inventory and working capital.

### A. Sources of funds (add narratives as required)

Loans	\$ _____
Mortgages	\$ _____
Equity	\$ _____
Total available cash	\$ _____

### B. Uses of funds

Capital goods	\$ _____
Inventory	\$ _____
Operating capital	\$ _____
Space improvement	\$ _____
Other	\$ _____
Total	\$ _____

## X. Financial.

Prepare a personal financial statement if you are seeking funds on your personal/family assets.

# Using Professional Help



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# Home-based Business – Planning

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## Personal Financial Statement

\_\_\_\_\_ (Date) \_\_\_\_\_

### Assets

Cash	\$ _____
Savings accounts	\$ _____
Stocks, bonds, other securities	\$ _____
Life insurance (cash value of whole-life policies)	\$ _____
Autos/other vehicles	\$ _____
Home, other real estate	\$ _____
Vested pension plan/retirement accounts	\$ _____
Other assets	\$ _____
<b>Total assets</b>	<b>\$ _____</b>

### Liabilities

Mortgage/land contract payable	\$ _____
Home equity loan/line of credit outstanding	\$ _____
Credit card balances	\$ _____
Other consumer loans (car, furniture, equipment)	\$ _____
Taxes payable	\$ _____
Other liabilities	\$ _____
<b>Total liabilities</b>	<b>\$ _____</b>

<b>Total assets</b>	<b>\$ _____</b>
<b>Less total liabilities</b>	<b>\$ _____</b>
<b>Net worth</b>	<b>\$ _____</b>



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It is vitally important for a small business owner to recognize the usefulness of information systems in a growing company.

Budgeting and expense controls; monitoring sales, operations and purchasing; and planning future business strategies all demand time and attention. It can spell disaster for the business if the owner relies on memory for all the business facts.

The owner-manager has three important areas that he/she must control:

- 1) The functional management needs of the business.
- 2) Marketing, sales, finance, personnel management, and the operations and organizational aspects of the business.
- 3) The business's products and processes.

## Resource people

Resource people can do a great deal for a small business. A professional consultant, an accountant, a lawyer, a banker and an insurance agent can provide expertise and know-how the owner doesn't have. They can spell the difference between success and failure. An overriding concern is to find professionals that deal with small businesses.

### *Bankers*

Get to know your local banker. Bankers have a great deal of financial advice they can share, as well as money. Perhaps you don't need money right now, but when the time comes to borrow, it is much easier if you have already

established a business relationship with the bank. Your business track record and personal reputation are very important when dealing with your banker.

### *Insurance agents*

Your insurance needs and costs will be determined largely by the type of business you establish. Fire, theft, liability, worker's compensation, surety bonds and fidelity bonds may all be needed. A good insurance representative can help you sort out your insurance needs. Your insurance agent should be someone you can trust, someone you can talk to and confide in. Shop around. It is surprising how quotes for the same coverage package can differ. You can start with the agent who handles your homeowner's insurance, but you may need to look elsewhere for specific coverage.

### *Accountants*

An accountant can do more for you than just do your taxes. It is to your benefit to develop a long-term relationship with an outside accountant. In many rural communities, a person who runs a bookkeeping service can provide help similar to that provided by an accountant. An accountant can provide the following services:

- 1) Review and develop your company's accounting needs.
- 2) Plan tax programs and prepare tax returns.
- 3) Assist in selecting and training a bookkeeping staff, if necessary.

# Home-based Business – Using Professional Help

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- 4) Advise on records and systems management.
- 5) Assist in establishing budgets and expense controls.
- 6) Prepare a financial statement.
- 7) Help determine a company's cash flow and capital requirements.
- 8) Help set up sound credit policies, if you establish personal credit for your customers.
- 9) Work with your attorney and other professionals.
- 10) Act as a sounding board for you as a business owner.

## Lawyers

A lawyer's advice may be needed on many matters. Contracts; leases; local, state and federal laws; questions about incorporation and many other areas may require legal counsel. It is much better to establish a working relationship with your lawyer when times are good than during an emergency! Be sure to discuss fees and payment schedules at the very beginning.

## Management/consulting services

A management consulting firm can help you develop your business plan, look for capital, buy equipment, do a marketing study or help you in many other ways. Some firms specialize in helping small businesses.

Names of consulting firms can be obtained from:

- Professional business schools and other educational bodies.
- Trade associations.
- Trade magazines.
- Bankers.
- Trade shows.
- Accountants.
- Competitors.
- Suppliers.
- Business friends.
- Field offices of the Small Business Administration (SBA), a Small Business Development Center (SBDC) or your Chamber of Commerce.

When working with a consultant, keep the following guidelines in mind:

- 1) Establish a good working relationship before you start. Most consultants will have an initial meeting at which you can meet each other, talk informally and explore your needs for the service. Often there will be no charge for this first meeting.
- 2) Consultants must be professional but at the same time accessible. You must feel comfortable with the person.
- 3) Establish the work schedule. What will the consultant need to do?
- 4) Establish a time frame and price for the service.
- 5) A final written report is essential. It should be complete and easy to read.



The most important thing to remember about any of these resource people is that you must be able to communicate your needs to them. If you are uncomfortable working with them, find someone else.

## Getting your business off the ground

It's necessary to follow some procedures as you set up your home business.

### Zoning

Do you own or rent your place of residence? Homeowners need to check the zoning laws in their city, town or township. Contact the city or township governmental offices — the planning department, planning commission, city or township clerk, or the township supervisor — for information on the zoning ordinances. There may be restrictions if you need deliveries made to your home or if you will have customers coming and going. There may be restrictions on certain equipment that is noisy or produces an odor. There may be some restrictions on the type of business as well, or on the size and placement of signs. Subdivisions and plats have additional rules and guidelines. Check these rules as well.

If you rent your home or apartment, read your lease carefully — it will state what restrictions are placed on operating a business there.

### Licenses

What forms need to be filed before opening a home-based business?

#### Assumed name

Register the name of your business with the county. You will need to file a DBA (Doing Business As form) with the county clerk. Cost is about \$10 and registration is good for five years. See page 33 for a sample form. This will protect the name of your business in the county. You need it to open a business checking account.

Check with county clerks within your marketing area to determine that you are not using a name registered by another business. Also check with the Name Availability Unit of the Corporation and Securities Bureau of the Michigan Department of Commerce before registering an assumed name.

#### Sales tax license

A sales tax license is required if you sell a product. File an application of registration for sales tax license, Form C-3400, with the Michigan Department of Treasury. You can do this through a field office or directly with the Michigan Department of Treasury Sales Tax Division, Treasury Building, Lansing, MI 48922. The sales tax license does not apply to a service business. The license enables you to purchase supplies for producing a product without paying sales tax. You must collect sales tax from your customers on any products you sell.



# Home-based Business – Using Professional Help

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CERTIFICATE OF PERSONS CONDUCTING BUSINESS UNDER ASSUMED NAME—Act No. 131, P. A. 1949. M 310 (REVISED 1978) REGISTERED MAIL & FEES REQUIRED HEREON

## Certificate of Persons Conducting Business Under Assumed Name

STATE OF MICHIGAN, } ss. FILING FEE \$10.00  
 COUNTY OF \_\_\_\_\_

The undersigned hereby certifies that ...he... (it) now own... (or) intend... to own, conduct or transact business at \_\_\_\_\_

in the \_\_\_\_\_ of \_\_\_\_\_  
 (City, Village or Township)

\_\_\_\_\_ County, Michigan, under the assumed name, designation and style of \_\_\_\_\_

The undersigned further certifies that the true or real full name and the address of the person' owning, conducting or transacting said business is:

NAME	PRINT OR TYPE NAMES AND ADDRESS STREET ADDRESS	CITY OR TOWN
_____	_____	_____
_____	_____	_____
_____	_____	_____

In Witness Whereof, I/We have this \_\_\_\_\_ day of \_\_\_\_\_, 19\_\_\_\_, made and signed this certificate.

### SIGNATURES OF PERSONS CONDUCTING BUSINESS UNDER ASSUMED NAME

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

STATE OF MICHIGAN, } ss.  
 COUNTY OF \_\_\_\_\_ On \_\_\_\_\_, 19\_\_\_\_, before me, a Notary Public, personally appeared the above named person or persons, whose signatures appear above, and who executed the foregoing instrument, and \_\_\_\_\_ he... acknowledged to me that... he... executed the same, and that they are all of the persons now owning, conducting and transacting or who intend to own, conduct and transact the business under the above name, style and designation.

\_\_\_\_\_  
 Notary Public, \_\_\_\_\_ County, Michigan  
 My commission expires: \_\_\_\_\_, 19\_\_\_\_

**THIS CERTIFICATE EXPIRES FIVE YEARS FROM DATE OF FILING WITH COUNTY CLERK**

(This portion to be filled in only by the County Clerk)

### THIS CERTIFICATE EXPIRES \_\_\_\_\_

STATE OF MICHIGAN, } ss.  
 COUNTY OF \_\_\_\_\_ I, \_\_\_\_\_  
 Clerk of the County aforesaid and Clerk of the Circuit Court for said County, do hereby certify that I have compared the within copy of Certificate setting forth the full names of the persons owning, conducting or transacting business under the name of \_\_\_\_\_

\_\_\_\_\_ together with the certificate of filing endorsed thereon, with the original Certificate heretofore filed and now remaining in my office, and that it is a true and correct copy thereof, and of the whole of such original Certificate and of said certificate of filing.

In Testimony Whereof, I have hereunto set my hand and affixed the seal of said Circuit Court, on \_\_\_\_\_, 19\_\_\_\_.

\_\_\_\_\_  
 County Clerk.

By \_\_\_\_\_  
 Deputy County Clerk.

NOTE: This Certificate must be renewed within (3) years from date. If you change your place of business you must notify this office. If you change the personnel above listed you must file Motion of Dissolution and a new Certificate with this office. If you discontinue your business you must file Motion of Dissolution with this office.

1. "Persons" may be one or more individuals, corporations, partnerships, limited partnerships, trusts, fiduciaries or other entity. In case of a person other than an individual, see MSA 19.236 (MCL 942.4) for details to be stated in certificate.

# Home-based Business – Using Professional Help

Michigan State University Extension



## Special business licenses

Do you need any special license for your type of business? Check with the Michigan Department of Licensing and Regulation at (517) 373-1870. Local libraries, Small Business Development Center offices or MSU Extension can get licensing information through their connection with the Michigan Department of Commerce's NEWBIZ computer system.

For a family day care business, you must register with your county Department of Social Services.

For food businesses, the department for licensing depends on the product you are selling:

- Catering — county Public Health Department.
- Bakery, cake decorating or food processing — Michigan Department of Agriculture, either a regional office or the state office (517-373-1060).

## Liability

Talk with your insurance agent or lawyer to determine the type of liability and property insurance you will need.

## Record keeping

Open a business checking account at a local financial institution. Set up a simple ledger system to keep accurate records of your sales and expenditures.

## Taxes (federal and state)

The following federal income tax publications and forms will be helpful as you plan for taxes. Contact the Internal Revenue Service at 1-800-829-1040 to request a copy.

IRS 334 - "Tax Guide for Small Business"

IRS 583 - "Information for Business Taxpayers"

IRS 587 - "Business Use of Your Home"

IRS 1040-ES - "Declaration of Estimated Tax"

IRS Schedule C - "Profit or Loss from Business or Profession"

IRS Schedule SE - "Computation of Social Security Self-Employment Tax"

Contact the Michigan Department of Treasury Revenue Division for:

Form MI 1040-Q - "Quarterly Estimated Tax Return".

## Legal questions

A lawyer experienced in home-based or small businesses can help you cover any legal matters, including :

- Copyright — Protection of any writing, photographs, artwork, computer program, etc.
- Trademark — A word, phrase or symbol that identifies your product or service in the marketplace.
- Patent — Right granted by the U.S. government for exclusive property rights to an invention to prevent others from making, selling or using your invention.



## Utilities

Check with your phone company about a business line. You will automatically get a listing in the yellow pages.

## Resources for home-based business owners

### *Michigan association*

Small Business Association of Michigan  
222 N. Washington Square, Suite 310  
Lansing, MI 48933  
(517) 482-8788

Service: Group medical insurance, monthly journal, state lobbying organization, small business political action committee, small business resource center, membership directory. \$150 annual membership fee.

### *Trade association information*

The Encyclopedia of Associations  
Gale Research Company  
Book Tower Building  
Detroit, MI 48826

Available at public libraries. Consists of four volumes: National Organizations of the United States, Geographic and Executive Indexes, International Organizations, and New Associations and Projects.

## Newsletters

*Barbara Brabec's Self-Employment Survival Letter*  
Barbara Brabec Productions  
P.O. Box 2137  
Naperville, IL 60567

Published bimonthly. Annual subscription cost is \$29.

*Work at Home*  
Ameritech

2000 W. Ameritech Center Drive 4B51E  
Hoffman Estates, IL 60196-1025

Free monthly publication. For a sample copy, call 1-800-967-5543.

## Commercial directories

*Thomas Register of American Manufacturers*  
Thomas Publishing Company  
1 Penn Plaza  
New York, NY 10001

Available in public libraries. A quick reference book for buyers of American-made goods arranged according to a simple system that will enable the user to find any specific kind of article desired.

*Michigan Industrial Directory*  
Harris Publishing Co.  
Twinsburg, OH 44087

Available in public libraries. Provides a county-by-county analysis of employment; lists cities in alphabetical sequence with corporate data on manufacturing companies; has 600 product groupings showing all manufacturers in the state; also lists manufacturers who constitute or serve an industry, and provides 3,600 product and subproduct classifications.

# Home-based Business – Using Professional Help

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## *Survey of Buying Power*

Sales and Marketing Management Magazine  
Bell Publications  
633 Third Avenue  
New York, NY 10017

Available in public libraries. Four survey issues, published in February, April, July and October. Provides estimates of demographic and socioeconomic facts for regions, states, metropolitan markets, counties and cities; gives a five-year projection of metropolitan markets in the United States and Canada. Provides data on four-digit SIC (Standard Industry Code) industries, both manufacturing and non-manufacturing.

## *Standard Rate and Data Service*

Available in public libraries. Provides complete media information, including data and advertising magazine rates, newspaper, spot sales, radio and television.

## *Federal government*

*Small Business Administration (SBA)*  
477 Michigan Avenue, Room 515  
Detroit, MI 48226  
(313) 226-6075

*Small Business Administration*  
220 W. Washington St., Room 310  
Marquette, MI 49885  
(906) 225-1108

Services: Booklets on a wide variety of topics, films, workshops, cassette tapes through SCORE (Service Core of Retired Executives). Direct service where no SCORE help is available.

## *Taxpayer Education*

Internal Revenue Service  
Patrick V. McNamara Federal Building  
477 Michigan Avenue  
Detroit, MI 48226  
(313) 226-3674

Services: Tax workshops, seminars and information booklets on tax laws.

## *U.S. Bureau of Census*

Available at public libraries. Statistical Abstract of the United States and Census of Housing.

## *U.S. Department of Commerce*

Available at public libraries. Census of Manufacturing Trade, Census of Wholesale Trade, Census of Retail Trade, Census of Selected Service Industries.

## *Local/regional resource*

### *Small Business Development Centers (SBDC)*

The Small Business Development Centers network is a joint state/federal government service that provides informational, technical, managerial, financial and other assistance to the small business community. Some of the Technical Assistance Centers across the state assess a fee for service.

# Home-based Business – Using Professional Help

Michigan State University Extension



The centers are located in:

## Upper Peninsula

- Houghton — Michigan Technological University
- Escanaba — 1st Step, Inc.
- Marquette — NEI Corporation

## Northern

- Boyne City — Northern Lakes Economic Alliance
- Traverse City — Traverse Bay EDC
  - Greater Northwest Regional CDC
  - Northwestern Michigan College
  - NW Michigan Private Industry Council
  - Traverse City Area Chamber

## West Central

- Big Rapids — Ferris State University
- Mt. Pleasant — Central Michigan University
- Sidney — Montcalm Community College
- Hart — Oceana County
- Scottville — West Shore Community College
- Cadillac — Wexford-Missaukee counties

## West

- Kalamazoo — Kalamazoo College
- Grand Haven — Association of Commerce and Industry
- Grand Rapids — Grand Rapids Community College
- Benton Harbor — Lake Michigan College
- Muskegon — Muskegon Economic Growth Alliance
- Ottawa — Ottawa County

## Bay Area

- Saginaw — Saginaw Future Inc.
- University Center — Saginaw Valley State University

## South Central

- Lansing — Lansing Community College
- Battle Creek — Kellogg Community College
- Howell — Howell Chamber of Commerce
- Saline — Washtenaw Community College

## Thumb Area

- Lapeer — Lapeer Development Corporation
- Flint — Community Development Corp.
  - Genesee Economic Area Revitalization (GEAR)
- Bad Axe — Huron County EDC
- Caro — Tuscola County EDC

## Metro Corridor

- Troy — Walsh-Oakland Community College
- Mt. Clemens — Macomb County
- Port Huron — St. Clair County Industrial Development Corporation
- Sterling Heights — Sterling Heights Area Chamber of Commerce
- Warren — Warren-Center Line-Sterling Heights Chamber of Commerce

## Southeast

- Detroit — Wayne State University Center for Urban Studies
  - Comerica Bank
  - University of Detroit/Northwest Institutional Leadership Action Council (NILAC)
  - Wayne State University Business School



## Specialty Centers

- Ann Arbor — Michigan Energy and Resource Research Association (MERRA)
- Lansing — Handicapper — Lansing Community College
- East Lansing — International — Michigan State University
- Houghton — Forest Products — Michigan Technological University
- Ann Arbor — Technology Transfer — University of Michigan

## Taxes and deductions for your home-based business

Owning and operating your own business has many tax benefits. The courts recognize the right of a taxpayer to utilize every opportunity that the law grants to decrease taxes.

Your first and most important step is to maintain accurate financial records. The time to start keeping records is immediately. Don't wait until business is better or you're making money. Keeping good records takes the worry out of filing taxes or a potential IRS audit.

### *Maintaining records*

1. Start by opening a business checking account. Pay all business expenses by check, if possible.
2. Obtain receipts for all expenses. Indicate on each receipt whether it was paid by cash or check. If a receipt cannot be obtained, record

the expense on a 3x5 card or a petty cash record with all the necessary details.

3. Record all your appointments, meetings, telephone calls and any other business-related activities in a date book or planner. This log is very important in establishing your business activity and business deductions for tax purposes.
4. Maintain a mileage log for business use of your personal car or truck. Record date, beginning and ending mileage, and business reasons for the trip.
5. Check with your insurance agent. Operating a home-based business may void your homeowner's policy unless you make special provisions. This also shows you are operating an active, on-going business.
6. Take a picture of your home-based business office. During an IRS audit, this is documentation of your business activity.

There is a difference between a home office deduction and other business expenses. There are standard business expenses that all businesses can deduct. But for home businesses, the home office deduction may be critical.

### *Home office deductions*

The rules for home office deductions are strict but worth looking at. Get a copy of IRS publication 587, "Business Use of Your Home", for the complete set of rules. Contact your local Internal Revenue Service office or call 1-800-829-1040. IRS 8829, "Expenses for Business Use of Your Home", is a step-by-step guide on how to calculate home office deductions.

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If you meet the IRS requirements, you may be able to deduct the following expenses:

1. Direct expenses.
  - Repairs to the business part of your home.
  - Painting of the business part of your home.
  - Other direct expenses.
2. Indirect business expenses. (The percentage of indirect expenses that can be deducted is based on the portion of your home used for business as a percentage of total square feet.)
  - Real estate taxes.
  - Mortgage principal and interest.
  - Lights, heat, water, gas.
  - Exterior painting.
  - Roof repair.
  - Landscaping.
  - Trash and snow removal.
  - Home maintenance.
  - Depreciation of yearly rent.

Rules for a day care facility are different than those for other home businesses. IRS Publication 587, "Business Use of Your Home", will explain these rules.

There are two other areas that you should make special note of:

1. There is a limit on how much you can deduct for the business use of your home.
2. If you use the home office deduction, you need to check IRS Publication 523, "Selling Your Home", for rules if you are planning to sell your home.

Our tax laws change every year, so it is important to seek the advice and counsel of a tax expert.

## References and resources

IRS Publication 587, "Business Use of Your Home"

IRS Form 8829, "Expenses for Business Use of Your Home"

IRS Publication 534, "Depreciation"

IRS Form 1040, Schedule C

IRS Publication 523, "Selling Your Home"

## Risk management and insurance

Risk management is the process of identifying and controlling the exposure of your business and personal assets to possible loss. These losses can occur from fire, theft, accidents or injuries to the public. The type of risk that involves the possibility of loss through burglary, fire, lawsuit or accident is called property loss. The other type of loss is liability loss. Liability loss occurs when a business is sued for something the business did (or failed to do) that caused injury or property damage to someone else. Sole proprietors and individuals in partnerships are personally liable for losses.

Risk management involves identifying the potential problem areas and developing strategies to handle the problems. It is vital to identify and control all risks affecting the business. When you buy insurance, you are trading a potentially large, unknown loss for a smaller, certain premium.

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There are four steps involved in identifying and controlling risk:

1. Identify the risks. Think about the “what if” situations that could happen.
2. Evaluate the potential risk. What chance of occurring does a particular situation have? What would be the cost of the loss if it occurred? What is the cost of the insurance to protect against the loss?
3. Select the type and amount of insurance. Shop around to find the company that can give you the best service and price.
4. Control the risk. Once risk has been identified, develop and implement a plan to manage it.
  - a. *Avoid or prevent the risk.* For example, don’t keep large amounts of money around. If people come to your home, be sure the sidewalks, steps and porch are clear of obstacles. If people must walk through your home, keep the area neat. If many of your customers are strangers, be aware of the possibility of shoplifting, even in your home business. If you have other people’s property in your possession, keep it in a safe place.
  - b. *Spread the risk around.* Keep copies of your records in a separate location from your business. Be sure customers are aware of their responsibilities. If they leave items for repair, set a time limit for pickup.
  - c. *Transfer the risk.* A good insurance policy will carry the burden of much of your “pure” risk. Let other businesses assume some of your risk. For example, hire

another business to deliver your products. The delivery company now pays the vehicle insurance.

It is very important to shop for insurance. The best approach is to get three quotes from professional agents. The agent should be willing to spend some time with you to analyze your needs. You’ll also want to know if the company will process a claim quickly and efficiently.

Ask other business owners for recommendations. Check with the Michigan Insurance Bureau for consumer complaint records of individual companies. Check advertisements in trade magazines for small companies that specialize in insuring your type of business. They may offer tailored insurance programs and personalized service. Don’t be surprised if price quotes from various companies differ greatly.

## *Basic types of insurance*

### **Liability**

Liability insurance will pay for your legal defense costs and judgments if you are sued by someone who is injured at your business. This includes customers and employees.

Worker’s compensation is a liability insurance that is required by law if you have one full-time employee who works 35 hours per week and has worked 13 consecutive weeks out of the past 52 or if you have three or more part-time employees. The rate is based on payroll and the type of work.



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## Property

Property insurance will pay for loss and damage to the contents of your home business. It also covers damage or destruction to improvements such as carpeting, fixtures and signs. The most basic form of property insurance will pay for losses due to fire, smoke, wind-storm, vandalism or malicious mischief, but it will not pay for water damage or theft of property.

## Business interruption

Business interruption insurance will pay for lost revenue if for some reason your business is closed. This insurance is complicated, but the best coverage will pay for total losses with no monthly dollar limit for a specified time. The amount you would receive is determined at the time you purchase the insurance.

## Automobile

Insurance that covers you and your vehicles. If you use your personal car or truck for business, check to see if you need additional coverage. You may wish to increase your liability coverage.

## Homeowner's

As a home-based business owner, you need to check with the company of your homeowner's insurance policy. Operating a business without informing your company may invalidate your insurance. Companies differ, so be sure to check with your agent.

## Other options

Insurance to pay for damage to other people's property that you may be holding for repair is one additional consideration.

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## Obtaining insurance

Below is a checklist of various types of coverage. This list will not, however, replace the advice of a professional insurance agent.

Coverage	Essential	Attractive	Availability
Worker's compensation			
A. Statutory benefits	X		High
B. Employer's liability	X		High
Public liability — bodily injury and property damage	X		High
1. Premises medical payments	X		High
2. Contractual liability		X	High
3. Products and completed operations coverage		X	High
4. Personal injury	X		High
5. Fire damage		X	High
Property — building and contents			
1. Fire/lightning	X		High
2. Extended coverage	X		High
3. Vandalism	X		High
4. All-risk coverage	X		High
5. Replacement cost	X		High
6. Flood insurance		X	High
7. Demolition insurance		X	High
8. Glass coverage		X	Medium

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## Obtaining insurance (continued)

Coverage	Essential	Attractive	Availability
<b>Property — use and occupancy</b>			
1. Business interruption		X	High
2. Accounts receivable		X	High
3. Extra expense		X	High
<b>Crime</b>			
1. Fidelity bonds		X	High
2. Safe burglary		X	Medium
3. Office burglary		X	Medium
<b>Automobile</b>			
1. Owned auto liability coverage	X		High
2. Auto physical damage		X	High
3. Medical payments	X		High
4. Uninsured motorist coverage	X		High
5. Hired auto coverage	X		High
6. Non-owned auto coverage	X		High
7. Broad form use of other autos	X		High
8. No-fault benefits	X		High
<b>Professional liability</b>			
1. Coverage for mistakes or errors	X		Low
2. Coverage for personal injuries	X		High
<b>Umbrella coverage</b>			
1. Blanket protection (covers excess of all primary insurance)		X	Medium
2. Limited protection (covers excess of public and auto liability only)		X	High



## Understanding copyright protection, trademarks and patents

### Copyright

The Copyright Act of 1976 went into effect January 1, 1978. The law extends copyright protection to “all original works of authorship” including works of art in all media. Under this law, copyrights are reserved to the creator for the duration of his or her life plus 50 years.

The act of creation alone affords a work copyright protection. Copyright protection begins the moment a work is “fixed in a tangible medium of expression” — that is, the moment pen is placed to paper, brush to canvas or stitch to fabric. The purpose of the copyright act is to enable artists and authors to control the reproduction of their work. The ownership of copyright may be transferred by a signed written agreement between the creator/owner and a buyer.

The publication or “distribution of copies...to the public by sale or other transfer of ownership, or by rental, lease or lending” without notice of copyright puts the work in the public domain — then it can be freely copied. Artists, writers and craftspeople should place a copyright notice on all works and all copies of their works before presenting them in any way to the public. The notice consists of the copyright symbol C or the word “copyright”, the year of first publication and the name of the copyright owner.

Examples: C 1994, Jane Doe  
Copyright 1994, Jane Doe

The notice should be on a conspicuous area of the work, such as on the title page of a booklet or pattern, on the hang tag of a soft toy or doll, or on the label attached to the item.

The copyright owner retains exclusive rights of reproduction even if that owner no longer owns the work itself. For example, a doll-maker who sells the doll itself still retains ownership of copyright on that doll until she transfers it to another party in a written agreement. Physical possession and copyright ownership are legally independent.

Registration of a work is necessary only to sue for infringement. There is a small fee for registration of copyright. The tests for copyright infringement are:

- 1) Did the infringer have access to the original work?
- 2) Is there substantial similarity between the original work and the alleged copy?

### Questions and answers about copyright

#### • What is “fair use”?

The Copyright Act of 1976 defines “fair use” as a legitimate use of a work by someone other than the copyright owner. For example, in criticism, scholarship, news reporting, etc., copyrighted material may be borrowed for publication by someone other than the copyright owner. The courts decide on a case-by-case basis what constitutes fair use by comparing public interest with the economic harm to

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the copyright owner along with questions such as how large a portion of the copyright work was copied, the nature of the work and the purpose of the allegedly infringing work.

- *Can I photocopy a copyrighted work for my own use?*

Libraries and archives are given restricted license to make just one reproduction of copyrighted material if there is no commercial advantage (the copy will not be used to undercut the price of the original) and the material is reproduced with its copyright notice. Most public photocopy machines must display a notice stating that duplication may be subject to copyright law.

Designers are very sensitive to having designs pirated via the photocopy machine. In a recent article, one designer stated, "Every time someone copies one of my charts it takes \$2 out of my grocery or rent envelope." Since making a living as a designer is risky at best, consider carefully the unauthorized use of someone else's original designs.

- *Is it OK to sell items I've made from how-to articles and patterns in magazines?*

Generally, magazines offer patterns and how-to instructions for people to use personally and for gifts. Designs in magazines are usually created by staff or freelance designers and all would be protected by copyright. Even if a designer sells rights to publish his/her design to a magazine, the designer retains all right to that item that he/she did not specifically sign away to the magazine. And, the magazine would be copyrighted as a serial (or collection

of works). It would probably be an infringement of copyright to make up items in a magazine in quantity. If you do make up such an item and decide to sell it, avoid problems by giving proper credit to the designer or the magazine by saying on the label or card "Design from (magazine's name)" or "Original design by (designer's name)."

The copyright laws are written to protect the creator of an original design. Profiting from someone else's creativity can be an infringement.

- *Can any- and everything be copyrighted?*

Ideas cannot be copyrighted. Only the expression of ideas in a tangible form can be protected by copyright.

Industrial designs are not protected by copyright. The Copyright Office distinguishes between a utilitarian object and an artwork that serves a utilitarian purpose. The overall design for a lighting fixture cannot be copyrighted, but a decorative, tole-painted base for a lamp could be copyrighted.

- *How much do I have to change someone else's design to be able to call it my original?*

To answer this question you would have to be able to legally define "substantial similarity" between the original work and the alleged copy. Each infringement suit is decided on a case-by-case basis. Therefore, legally defining "substantial similarity" is impossible.

Generally, altering the way a design is used (for example, taking a folk-style cross-stitch

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design and converting it to a stencil design) would not alter the fact that it's a copy. The copy does not have to be an exact copy — it only has to repeat a "substantial part" of the design.

According to an attorney and author on copyright law, the test for infringement is whether an ordinary observer looking at the two works would say one was copied from the other.

This section on copyright is for your information only. It does not constitute legal advice; nor does it take the place of an attorney's service. It represents current information and opinion as it affects craftspeople in small, home-based business.

For further information and registration forms, write for: "Circular R - Copyright Basics," Library of Congress, Washington, DC 20449.

## Trademarks

A trademark is a word, phrase or symbol that identifies your product or service in the marketplace. To establish ownership of a trademark, you must file an application. The filing fee is \$200. All information can be obtained from the booklet "General Information Concerning Trademarks," which is free from the Patent & Trademark Office, U.S. Department of Commerce, Washington, DC 20231.

*(Adapted from an article by Georgia Adcock, Georgia Cooperative Extension Service, 1985.)*

## Patents

Innovative ideas are essential to business progress. This section, which is aimed at idea people, inventors and innovative owner-managers of small companies, describes the tests that every idea must pass before it makes money.

Owner-managers who have started companies on new ideas know firsthand about the innovation process. They also know that you can expect to hear....

### You've got an idea? So what?

In the first place, the chances that you are the first to come up with a particular innovation are somewhere between slim and none. Secondly, even if you have come up with the better mousetrap, nobody, but nobody, is going to beat a path to your door.

Why is it so hard to find backers for your brainchildren? One consultant put it this way: "Nobody wants unproven ideas. Nobody wants to be first. Everybody wants to be second." Why this fear of new?

Well, new product failure rates are estimated conservatively to be between 50 and 80 percent. One survey of major companies with millions of dollars to spend on R & D, market research and product advertising, and with well established distribution systems found that of 58 internal proposals, only 12 made it past initial screening. From these 12, only one successful new product emerged.

Another group set up to help innovators has found that of every 100 ideas submitted, 85

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have too many faults to bother with. They can be eliminated immediately. Of the remaining 15, maybe five will ever be produced. One of those might — only might — make money.

With odds of 99 to 1 against an idea being a monetary success, is it any surprise that your idea is greeted with a chorus of yawns? People — companies, investors, what-have-you — are basically conservative with their money. Ideas are risky.

Does that mean you should forget about your idea? Of course not. It merely means that now you're beginning to see what Edison meant when he said, "Genius is 1 percent inspiration and 99 percent perspiration."

Again, those of you who started on innovations are well aware of the truth of Edison's words. You've been through the hard work.

## Can you exploit your idea?

Though coming up with what you think is a surefire idea is the biggest step, it's still only the first one. You've got the other thousand miles of the journey to success still ahead of you.

Many things remain to be done before you can expect the first dollar from your invention or other innovation. You should be prepared for the unhappy discovery that the end of the line for your idea may turn up well before the point you needed to reach to make money on it.

At a bare minimum, your idea will have to pass the following tests:

- Is it original or has someone else already come up with it?

- Can someone produce and distribute it, if it's an invention or other product; or use it, if it's a marketing innovation, a new use for an existing product or the like?
- Will it really make money? (Will someone buy it?)
- Can you protect your idea?

That seems to be a modest enough list — and it is. The problems arise from the dozens of underlying questions that must be answered before the major questions can be resolved. Here, for example, are the 32 areas that the University of Oregon's Innovation Center looks at to determine if a submitted idea has commercial merit:

Legality  
Safety  
Environmental impact  
Societal impact  
Potential market  
Usage learning  
Product visibility  
Service  
Durability  
New competition  
Functional feasibility  
Appearance  
Price  
Protection  
Payback period  
Profitability  
Product interdependence  
Research and development  
Stability of demand  
Consumer/user compatibility  
Marketing research

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Distribution  
Production feasibility  
Development status  
Investment costs  
Trend of demand  
Product line potential  
Product life cycle need  
Promotion  
Perceived function  
Existing competition  
Potential sales

That is not a modest list. For the moment, however, let's ignore the 32 and look at the four broad questions.

## Is your idea original?

Obviously, if somebody has already devised and produced as good an item or a better one, it would be pointless for you to pursue a similar idea any further. You'd only be wasting your time and money.

There are lots of places to look to find out. If your idea is for a consumer product, check stores and catalogs. Check trade associations and trade publications in the field into which your invention fits. Visit trade shows relevant to your idea. Look in the business and popular press. You can consult *The Reader's Guide to Periodical Literature* to help you in your search. Your public library has a copy.

Don't be afraid to ask people in the field if they've ever heard of anything along the lines of your idea. In the pure idea state, it's not very likely that somebody will steal your idea — all the hard work still has to be done. Besides, you can ask general sorts of questions and keep the

details of your idea to yourself if you're really anxious that your idea will be pirated.

Obviously, if your invention or idea can be put into patentable form, you'll eventually have to make a patent search. You could do that in this early stage, but it's probably better to hold off until you've taken a look at your idea in the light of the next two questions.

## How will the invention be produced and distributed?

The first thought that many innovators have is to take their ideas to a big national company. Provide the dazzling idea, they think, and let the giant work out the details. After all, the national company has the money, the production capability and the marketing know-how to make this surefire profit maker go.

Unfortunately, the big companies are almost never interested in ideas from outsiders. It doesn't matter whether that's because, as one innovation broker has suggested, outside technology is "a risk, a threat," or because large corporations need potential sales of an item to be in the tens of millions of dollars. The cold fact is that the odds of selling a big firm on your idea are in the 100,000 to 1 range.

On the other end of the scale, you may be able to produce some items yourself, working out of your home and selling by mail order. This method can be a good way to get started, but after a while you may find yourself getting tired of having 200,000 better mousetraps stashed in your bedroom.

To be sure, if you can start (or already have) your own company, you will be better off. It's



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easier to sell a company than a patent, even if the company is losing money.

Many potential buyers understand a company much better than they understand the technology of an invention. Business people usually look at the profit-and-loss possibilities differently from the way an innovator does.

Between the extremes of starting your own company or having big business buy you out is taking your idea to small and medium-sized businesses. Such firms would be happy to produce an item producing sales in amounts that simply don't interest large companies. Smaller firms may lack marketing and distribution expertise, but again your major problem is even finding one that can help you realize your idea and is interested in trying.

## Will your idea make money?

This is the question that worries everybody. Here is where the risk arises that makes it so difficult to interest people in backing your idea.

It's a question that's really impossible to answer with any assurance. After all, major corporations, even those with massive market studies, hit clinkers all the time. Remember the Edsel? On the other hand, an idea seemingly so stupid that you'd think it was a silly joke might make millions. Don't you wish you'd thought of the pet rock?

So many factors need to be considered to answer this question. Is there a market? Where is it? Is it concentrated or dispersed? Could the size of the market change suddenly? Will competition drive you out? These questions are by no means the bottom of the iceberg.

But, answering the money question to the satisfaction of potential backers is the key to the other questions.

## Can you protect your idea?

Once you've come up with tentatively satisfying answers to the originality, production and distribution, and salability questions, it's time to consider protecting your idea. After all, it looks as if you may have something.

A patent is an exclusive property right to an invention issued by the Commissioner of Patents and Trademarks, U.S. Department of Commerce. To be patentable, your invention must be (1) new or novel, (2) useful or have utility and (3) non-obvious.

If you do have a patentable item, here briefly are the steps you'll need to follow to protect it under the patent laws:

Get a close friend (who understands your invention) to sign his or her name on a dated diagram or written description of the invention. You can also file written disclosure with the Patent Office. This office has a "Disclosure Document Program" that permits placing the disclosure on file, in confidence, for two years. The fee is \$10. Send to Commissioner of Patents and Trademarks, Washington, DC 20231. Sending yourself a registered letter describing the invention is useless as evidence.

Although you can file for your own patent application, it is strongly advised that a patent attorney or agent be used. You can find patent attorneys/agents in the yellow pages, or you can buy a roster titled "Directory of Registered Patent Attorneys and Agents Arranged by

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States and Counties” from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Fees charged by patent attorneys or agents for application will generally range from \$1,000 to \$5,000. Costs depend on the complexity of the invention, the number of rejections by the patent examiner or other proceedings.

Invention promotion firms are also listed in the “Patents” section of the yellow pages. These are firms that offer to take on the whole job of protecting and promoting your idea for a fee. Caution is necessary in dealing with such promoters.

If you elect to use an idea promotion firm, make sure:

- It can provide you with solid evidence of its track record — not just a few flashy success stories, but verifiable statistics on the number of clients the firm has had and the number who have actually made money.
- It doesn’t collect the entire fee in advance.
- It will provide you with samples of promotional materials and lists of companies to whom they’ve been sent. (Then check with those companies yourself.)

You can check the promotion firm’s reputation with the local Better Business Bureau, Chamber of Commerce, a patent attorney, or a local inventors or innovators club.

## *Invention brokers*

Brokers work for a portion of the profits from an invention. They may help inventors raise

capital and form companies to produce and market their inventions. They often provide sophisticated management advice. In general, you can expect these brokers to be interested in more complex technology with fairly large sales potential.

## *Small Business Administration*

The SBA’s Small Business Institutes (SBIs) are located at more than 450 colleges and universities around the country. Few SBI schools can provide much help with the technical R & D aspects of innovations, but they certainly can provide the market research, feasibility analysis and business planning assistance necessary to make an innovation successful. The SBA offices in Detroit and Marquette can provide you with information about the SBI program. (See the resource list.)

You may find that other management assistance programs offered at the Small Business Development Centers will help you realize your idea as well.

## *National Bureau of Standards*

The office of energy-related inventions in the U.S. Department of Commerce’s National Bureau of Standards will evaluate non-nuclear energy-related inventions and ideas for devices, materials and procedures without charge. If the office finds that the invention or idea has merit, it will recommend further study by the Department of Energy. The Department of Energy may provide support for the invention if it shows promise. This process may take from nine months to a year.

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## *Inventors' clubs, associations and societies*

You may have such clubs in your locality. You can share experiences with kindred spirits and get good advice, low-cost evaluation and other help.

Talking with other inventors is probably the most helpful thing you can do. Find someone who has been through the entire routine of patents, applied R & D and stages of financing. It doesn't matter if the end result was a financial success or a failure. Getting familiar with the nitty-gritty of the process is what's important.

(Adapted and used by permission from *The Peddler's Cart*, Michigan State Entrepreneurs Association, July-August 1985.)

## Family or employees — who needs them?

### *Your spouse*

The long-term success of your home business depends on knowing when you need help. For most home-based business owners, using their family is the first step when they need help. In many home-based businesses, a spouse helps out but is not on the payroll. There is nothing wrong with this arrangement. Or in a sole proprietorship, the owner can hire his/her spouse as an employee and deduct the wage as a business expense. The spouse/employee must be on the books to get Social Security coverage.

### *Your children*

Another possibility is to hire your children. You must pay them a reasonable wage for the work performed and you can deduct the wage as a business expense. The wages earned by the child are taxed at the child's rate once the child is over the age of 14. A child under age 18 who works for a parent is not subject to Social Security withholding or employer tax. Your child's compensation will be tax deductible if:

- The child actually renders services to the business.
- Wages are reasonable in relation to services rendered.
- Payments are actually made.

### *Employees*

As your business grows, you may find that hiring an employee is the next crucial step. Finding the right person can be a real challenge. Before you hire an employee, check your zoning regulations on employees in your home. Then use the following checklist. If you can answer "yes" to the majority of the following questions, you're ready for an employee.

- Has your business grown significantly?
- Is your workload too heavy to handle in a timely manner?
- Have you streamlined your work plan and found you're still overloaded?
- Is your business demanding more energy than you have to give?

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- Has overwork decreased your efficiency?
- Do you have sufficient income to pay an employee?
- Do you have skills to manage an employee?
- Are you willing to spend time training and developing an employee?
- Can you delegate authority?
- Are you willing to share the responsibilities and rewards of your business with another person?

Before you make up your mind, ask yourself if you're prepared to cope with the disadvantages of being an employer. "Yes" answers to the following group of questions mean that you're realistically prepared to hire an employee.

- Is an employee worth the extra work, responsibility and liability?
- Are you willing to spend time planning your employee's work schedule?
- Are you prepared to keep accurate records pertaining to regular hours worked, over-time and vacations?
- Do you have time for the added paperwork required by federal and state governments?
- If the necessity should arise, could you fire as well as hire?

## *Whom do you need?*

What needs does your business have? You must determine the specific kinds of tasks your business requires. After each task, esti-

mate the number of hours each would take during the week.

- List each task that needs to be done.
- Consolidate the tasks into broad categories.
- Write a job description.

The job description should include the title of the job, specifics on the tasks to be done and a realistic assessment of what you expect the employee to accomplish.

You may find you need only one more employee or you may need several. The important thing is to know what kinds of jobs you need to fill.

## *Where do you find them?*

Once you have the job description, you are ready to look for your employees. There are many places to look:

Schools, public and private - High school counselors can help you find reliable young people looking for jobs. College campuses and business and trade schools often have placement services for their students.

Help wanted ads in the newspapers. When writing your help wanted ad, you should always cover the following points:

- Job title.
- Brief description of responsibilities.
- Personal requirements and experience needed.
- Working conditions.
- Suggestion of pay scale, benefits.
- How and when to contact; phone, mail or in person.

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- Firm name, address or box number.
- Individual to contact (optional).

Referrals from friends or relatives - You may find leads from many sources once you let the word out that you are looking for an employee.

## *How will you get information?*

You may wish to use a standard application form that it is available in an office supply store and adapt it to your business. You need to be sure that you ask each potential employee the same set of questions and look at similar qualifications.

## *How do you keep them?*

What should you pay your employees? Are they covered by minimum wage laws? What kinds of benefits should you offer? You must answer all these questions when hiring employees.

## *Pay the job, not the employee*

Establish wage scales for the job. You have written your job description so you know what you'll require of an employee. Build in a range of possible pay levels to recognize and reward individual workers' differences.

For example:

\$4.35/hr.	\$4.85/hr.	\$5.10/hr.
low	medium	high

## *The law, the employee and wages*

Federal law views an employee as any individual who is assigned and held responsible for a specific list of responsibilities and output with predetermined hours of work, and whose relationship with an employer may be severed if those responsibilities are not met.

### Fair Labor Standards Act

The U.S. Fair Labor Standards Act applies basically to any firm that has gross sales exceeding \$500,000, is involved in interstate commerce, or employs four or more people other than the owner or members of the owner's family during a business year. The law regulates basic wage standards, overtime, equal pay and child labor.

For more information contact:

U.S. Department of Labor  
Grand Rapids, 616-456-2183  
(Wage and hour questions)

State of Michigan - Wage and Hour Division  
Lansing, 517-322-1825

### Hiring employees — state and federal guidelines

To select an employee, you need to understand state and federal laws governing employment. Various laws cover advertising, screening, interviewing, selection, compensation and promotion policies.

A business that hires employees must contact the Michigan Employment Security

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Commission (MESC) in the Department of Labor on or before the last day of the month following the month in which it becomes an employing unit.

Michigan employers are liable for payment of an unemployment compensation tax and for withholding state income tax from employees' compensation.

The business ombudsman's office in the Michigan Jobs Commission (1-800-232-2727) provides an employer's package that contains all the required forms, posters and applicable Michigan laws dealing with the requirements of being an employer.

The Michigan Department of Treasury Income Tax Division will also provide information.

## Income tax withholding

Every employer is required to withhold federal income tax and Michigan income tax from compensation paid to an employee.

Employers should register with the Department of Treasury by completing form C-3400.

It may be necessary for you to complete IRS form SS-4, which is the application for an employer identification number. This form is required if a business is employing one or more persons or if it is a partnership or a corporation. It is not necessary for a sole proprietorship that does not employ others.

However, some banks require a business to obtain a federal identification number when having business checks printed.

Your federal ID and state ID will be the same number.

## Employment of minors

The administration and enforcement of the legal employment of minors is the responsibility of the Bureau of Employment Standards of the Michigan Department of Labor. The law provides for the legal employment and protection of minors under 18 years of age. It defines legal employment for all minors ages 14 through 17 years who are employed or permitted to work in any gainful occupation.

An employer covered by both federal and state laws must comply with the provisions of both laws that will provide the highest standard of protection for employed minors.

For additional information or to obtain application forms for employing minors, contact the Bureau of Employment Standards of the Michigan Department of Labor.

## Immigration law restrictions

You are required to verify the eligibility of all employees hired within three business days of each hire. As an employer, you will need to fill out and retain Form I-9. The employee fills out the top portion of the form, indicating whether he/she is a citizen, an alien lawfully admitted for permanent residence or an alien authorized by the U.S. Immigration and Naturalization Service (INS) to work in the United States.

The bottom of the form lists various forms of identification and employment eligibility doc-

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uments the employee must provide for you. You can obtain copies of form I-9 and the employer's handbook from the nearest office of the U.S. Immigration and Naturalization Service, or call 1-800-755-0777.

## *Planning the interview*

Conducting a 45- to 50-minute interview sounds like a formidable task, but you can make it easier by dividing the procedure into five steps.

### 1. Prepare for the interview.

Review the person's application and any other correspondence and telephone conversations that you have had so that by the time you sit down for the interview, you'll be familiar with the candidate's experience and educational background. Checking over this background information will help you identify areas you want to clarify.

Write an interview outline that includes time slots for:

- Greeting and putting the prospective employee at ease.
- Questioning the applicant about job interests, goals, strengths and limitations.
- Asking the prospect about experience, educational background and specific tasks.
- Giving information about the job and your business.
- Answering questions the applicant might ask.

- Clarifying any loose ends.
- Wrapping up the interview.
- Follow-through, which includes letting the applicant know he/she will be notified and whether it will be by phone, mail or in person.

### 2. Let the conversation flow.

An interview is meant to be a two-way conversation. Because you've written your interview outline, you won't have to worry about what to do next, so you can actively listen to the candidate. Restate what is said and build on the candidate's responses.

Look for non-verbal clues. "Body language" can reveal much about the candidate's attitudes and feelings. Take notes if you must, but sparingly, so it doesn't distract from the business at hand. It is best to jot down notes about your impressions of the applicant immediately following the interview.

### 3. Be open for communication.

Act natural and show a genuine interest in what the applicant has to say. Concentrate on the applicant's thoughts, words and actions and don't attempt to judge the applicant until after the interview. Some interviewers damage the lines of communication by being judgmental and putting the prospective employee on the defensive.

### 4. Strive for a balanced interview.

During an interview, you are constantly comparing the elements of the application with the job requirements. You must give as well as

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receive information. You'll want to know all about the candidate's previous job experience and interests. The candidate, in turn, will be eager to learn as much as possible about you and the job you want to fill.

## 5. Evaluate the applicant.

Perform this important step right after the interview, while your impressions are fresh. Pay special attention to your "gut" reaction — those instincts are often right on target. Make yourself an assessment form for each applicant you interview. It should include job requirements (gleaned from the written job description), level of education and experience, special skills, people skills and any other special requirements for the job. Use a rating scale of 1 for unsatisfactory, 2 for acceptable, 3 for good and 4 for superior to rate each applicant in each category.

Good interviewing skills are essential because hiring the right employee can save you time and money, as well as enhance and enrich your business.

## A final note on interviewing

Check your questions before the interview to make sure they conform with equal employment opportunity practices. To employ fairly, you need not remember a lot of rules as long as you keep one basic tenet in mind: any questions you ask and any test you administer must be relevant to the job.

The Equal Employment Opportunity (EEO) Act has a number of implications for interviewing. Many hiring decisions are made on the basis of interviewer/interviewee inter-

action rather than job-related factors. To guard against this bias, "bona fide occupational qualification" (BOQ) has become a key phrase. Does what you ask in the interview relate to performance? If you say that short hair is a requirement to drive a truck, be prepared to prove that short hair is a BOQ. The burden of proof is on the employer in a lawsuit.

Subjects to be avoided in an interview are:

- Marital status.
- Birthplace.
- Age.
- Religion.
- How or when citizenship was obtained.
- Extracurricular affiliations or memberships in organizations.
- Wife's maiden name.
- Applicant's maiden name.
- Relatives (except whom should be contacted in case of emergency).
- How skill in a foreign language was acquired.
- Arrest for a crime (you may inquire about conviction, however).
- Children.
- Physical size and weight.
- Garnishment of wages.
- Possessions such as home or car (unless a vehicle is required to perform the job).
- Spouse's or father's/mother's job.
- You also may not request an applicant's photo.





The following areas are not illegal per se but, depending on why they are used, may be unfair employment practices. The best approach is to avoid questions about these areas:

- Credit rating.
- Military service. It is acceptable to ask about general military service but not the type of discharge.
- Family. Generally, questions related to marital status, divorce, unwed motherhood, children, child care, occupation of spouse, spouse's attitude and relatives working for the organization may be construed as discriminatory.
- Commuting. Commuting distance is not a legitimate reason for rejection.
- Education. It is up to the employer to prove that a certain level of education correlates with success on the job.
- Written tests.
- Unions. Asking applicants if they belong to a union or have any objections to joining a union is a violation of the Taft-Hartley Act.
- Discrimination charges. Asking about an applicant's involvement in a discrimination suit against another employer is asking for trouble.
- Disabilities. The question that needs to be asked is if the applicant can physically and mentally do the job.

The best way to comply with the law is to have a good job description. During the job interview, ask job-related questions and treat all applicants alike.

## Check references

The reference check is the final step in the selection process, so you need to do this for the one or two applicants best qualified for the job. As a general rule, former employers have no legal obligation to give you any information about a former employee. As a practical matter, however, most former employers will at least verify the employment and date of employment. Contact references by phone and be sure to inquire about the candidate's perceived strengths and weaknesses and the reasons behind the evaluations you receive.

## Interview plan

### I. Pre-interview contact

1. Application
2. Resume
3. Other correspondence
4. Telephone

Time frame    The interview

5 minutes    II. Openers — friendly, informal

- 1.
- 2.

10 minutes    III. Questions about the applicant

1. Work goals, aspirations
2. Work strengths
3. Work limitations

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10 minutes IV. Job-related questions

1. Experience
2. Educational background, as it pertains to the job

10 minutes V. Giving information about the job and the business

- 1.
- 2.
- 3.
- 4.

VI. Questions you think applicant might ask

10 minutes VII. Clarifying

1. Fill in gaps
2. Match key requirement to applicant's background and experience
3. Other

5 minutes VIII. Wrap-up

- 1.
- 2.

IX. Follow-through

1. Reference check
2. Date applicant will be notified of results
3. Method of notification — mail, phone, in person?

## Employee assessment

Job \_\_\_\_\_

Name \_\_\_\_\_

Date \_\_\_\_\_

Use a rating scale to help you:

Unsatisfactory = 1

Acceptable = 2

Good = 3

Superior = 4

Job requires:

1. Knowledge (What does the applicant need to know to be hired?)

What does the applicant tell you during the interview?

Rating: \_\_\_\_\_  
Comments: \_\_\_\_\_

List the requirements:

- a.
- b.
- c.
- d.

2. Special skills (Are there special skills the applicant must have? Does he/she need to be able to sew, run an adding machine, drive a car?)

Rating: \_\_\_\_\_  
Comments: \_\_\_\_\_

Adapted from: *Managing the Interview*. Olson, Richard Fischer. John Wiley & Sons, Inc. New York, 1980.

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Job requires:

*What does the applicant tell you during the interview?*

List the requirements:

- a.
- b.
- c.
- d.

3. People skills (Will the applicant have to deal with customers, answer the phone?)

Rating: \_\_\_\_\_  
Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

List the requirements:

- a.
- b.
- c.
- d.

4. Other (Anything special about this job? Do employees need to work evenings or weekends?)

Rating: \_\_\_\_\_  
Comments: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

List requirements:

- a.
- b.
- c.
- d.

## Employee or independent contractor?

Many employers try to avoid their legal responsibilities by hiring independent contractors. There is a distinction between an employee and an independent contractor.

The independent contractor is personally responsible for Social Security payments and unemployment and worker's compensation insurance. If you use independent contractors, they must be truly "independent." For a determination of whether a worker is an employee or an independent contractor, submit IRS form SS-8.

To be certain that the person you hire maintains his/her status as an independent contractor, pay for a completed or specific job or amount of work rather than by the hour.

Here is a quick guide to determining whether the person is an employee or an independent contractor: <sup>1</sup>

### 1. Instructions.

Employees comply with instructions about when, where and how work is to be performed.

Contractors set their own hours and do the job in their own way.

### 2. Training.

Employees are trained to perform services in a particular way. They are required to attend meetings.

Contractors use their own methods and receive no training from the purchaser of their service.

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## 3. Integration.

Services of an employee are merged into the business. Success and continuation of the business depend on these services. The employer coordinates the work of one employee with that of other workers.

The success and continuation of the business don't depend on services proved by the contractor.

## 4. Services rendered personally.

Services must be rendered personally. An employee does not engage other people to do the work.

Contractors are able to assign their own workers to do the job.

## 5. Hiring, supervising, paying.

An employee hires, supervises and pays other workers at the direction of the employer.

Contractors hire, supervise and pay other workers as a result of a contract. A contractor agrees to provide materials and labor and is responsible for the results.

## 6. Continuing relationship.

An employee continues to work for the same person year after year.

Contractors are hired to do a job. The relationship may not be continuous.

## 7. Set hours of work.

An employee's hours and days are set by the employer.

Contractors are masters of their own time.

## 8. Time required.

An employee normally works part time or full time for an employer.

Contractors are free to work when and for whom they choose.

## 9. Doing work on the employer's premises.

Employees work on the premises of an employer.

Contractors work off an employer's premises and use their own offices, desks and phones.

## 10. Order or sequence set.

An employee performs services in the order or sequence set by the employer. For example, salespersons report to the office at specific times, follow up on leads and perform certain tasks at certain times.

Services are performed at a contractor's own pace. For example, salespersons work their own schedules and usually have their own offices.

## 11. Oral or written reports.

Employees are required to submit regular oral or written reports to the employer.

Contractors submit no reports.

## 12. Payment for work performed.

Employees are paid by the employer in regular amounts at stated intervals for the time worked.

A contractor is paid by the job.

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## 13. Payment of business and/or traveling expenses.

The employer pays employees' business and/or travel expenses.

Contractors take care of their own expenses and are accountable only to themselves for expenses.

## 14. Tools and materials.

An employer furnishes tools, materials, etc.

Contractors furnish their own tools, etc.

## 15. Worker's investment.

An employee has no significant investment in the facilities used to perform services.

A contractor has a real, essential and significant investment.

## 16. Realization of profit or loss.

An employee cannot realize a profit or loss by making good or bad business decisions.

Contractors can realize a profit or suffer a loss as a result of their services or decisions.

## 17. Working for more than one firm at a time.

An employee usually works for one employer at a time.

An independent contractor works for a number of persons or firms at the same time.

## 18. Making services available to the general public.

An employee does not make services available to the general public.

Contractors have their own businesses. They hold business licenses, are listed in business directories, maintain business telephones and generally make their services available to the public.

## 19. Employer's right to fire.

An employee can be discharged at any time.

Contractors cannot be fired so long as product results meet contract specifications.

## 20. Worker's right to quit.

Employees can quit their jobs at any time without incurring liability.

Contractors agree to complete a specific job and are responsible for satisfactory completion — they are legally obligated to make good for any failure.

Hiring an independent contractor is legal and can be a good business practice for the small business person, as long as you remember the distinction between employees and contractors.

<sup>1</sup> Adapted from SCORE Kalamazoo, "Employee or Independent Contractor? A Quick Guide." March 1993.

# Record Keeping



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# Home-based Business – Record Keeping

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Records are the glue that holds a business together. Many a home-based business owner would prefer making the product or providing the service to keeping records. But records provide important information on actions, inventory, contacts and transactions. A good record-keeping system will save you time you would otherwise waste looking for misplaced information.

The key to good record keeping and a filing system is the ability to find what you want when you need it. No record-keeping system maintains itself — it takes regular use.

Some suggested headings for your filing system are communications, financial, legal, marketing, clients, accounts payable, accounts receivable and inventory.

## Financial record keeping

Most small businesses do not need a complicated financial record-keeping system, but a simple and complete system is essential for tax purposes and for business management. Records enable you to assess the progress of the business, make changes and adjust your financial decisions. Records and the reports you get from your records will help you to:

- Keep track of the financial progress of your business. No business can operate if it does not have a positive cash flow. A record-keeping system will organize your financial affairs and help you spot potential problem areas.

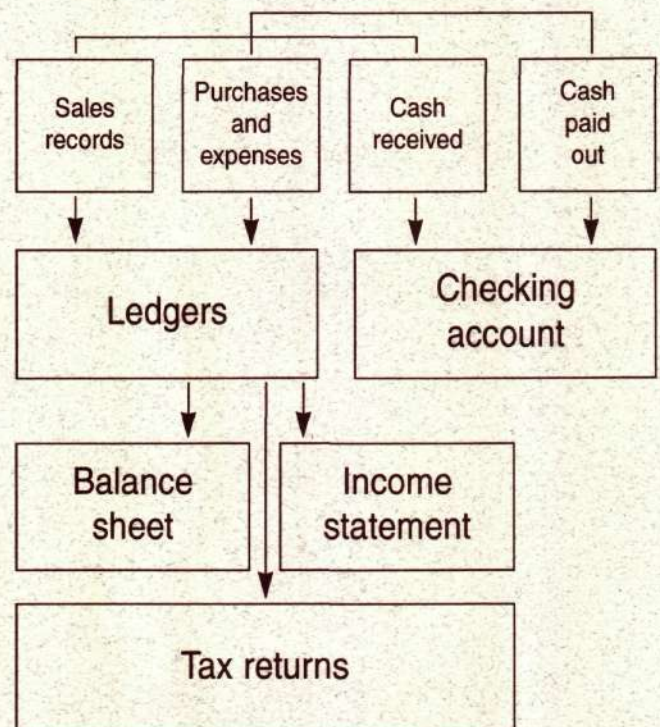
- Complete the necessary forms for your federal and state income taxes and Michigan sales tax.
- Provide a professional way of dealing with customers, vendors and financial advisors.

Develop a simple system by:

- Keeping all your records in one place.
- Developing a regular schedule for recording information.

## Basic parts of the system

Think of your record-keeping system as a flow chart.





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You will need to have the following basic system in place:

- A business checking account. It is not a good idea to run your business through your personal checking account. Before opening an account, a financial institution will ask for your DBA (Doing Business As) form, which identifies the name of your business on the checks. A business checking account establishes your business as the financial institution's customer. This will help if you need other banking services.

Shopping for a business checking account is critical. Don't assume that you will find the best pricing where you currently have your personal account. Depending on the number of checks you write per month, charges may vary greatly.

Tips:

1. Remember to balance your account monthly.
2. Never write a check to "cash" unless it is to cover your personal draw, the money you are taking out of the business for personal income.
3. If you have expenses that are both business and personal, it is better to write the check from your personal account and then reimburse your personal account from your business account.

## Recording income

Depending on your business volume, you will need to develop a receipt for your customers.

If you have a low volume (not dollar volume, but low number of transactions), consider a bill for each sale that includes:

- Your name, address and phone number.
- Date of sale.
- Customer's name and address.
- Description of the sale.
- Dollar amount, showing sales tax separately.
- Space to indicate date paid (optional).

If you have a moderate volume of sales and cannot make out a bill for each sale, consider a cash receipt book. You can have a book printed with your name, address and phone number and just fill in the blanks, or you can purchase a book of blank receipts from an office supply store. You can stamp your company name on each receipt. Consider making a carbon copy for yourself so that you can give the original to the customer. Be sure to number your receipts.

You will then deposit all your receipts into your checking account. Next, you will use an income ledger to give you information on your sales.

*An income ledger.* A ledger is no more complicated than a sheet of paper with rows and columns. The columns are labeled with categories and the rows show dates. As sales are made and deposited into your checking account, they are also entered into the ledger. The ledger entry will give more information about your sales than the deposit slip. For example, if you are selling both wholesale and retail, you will want to put these sales in separate columns to have an accurate accounting

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## An income ledger

Business Name \_\_\_\_\_ 19\_\_\_\_

	Date	Paid To	Check Amount	✓	Check Number	Deductions						
						Advertising	Bank Service Charges	Car & Truck Expenses	Commissions	Dues and Publications	Employee Benefit Program	Ins
1					1							
2					2							
3					3							
4					4							
5					5							
6					6							
7					7							
8					8							
9					9							
10					10							
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29					29							
30					30							
31					31							
32					32							
			Check Amount									
Totals This Page												
Totals Previous Page												
Totals to Date												

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of how much sales tax you will owe to the state of Michigan. Or you might choose to have categories that correspond to your major sales categories. For example, you divide your products or services into sales categories and record the income by category to track sales results. Each month you will total your sales for the month. As the months progress, you will add together the months to get your annual sales volume.

*An expenditure ledger.* This ledger, though similar in concept to the sales ledger, is for the expenses you incur in your business. As you pay your bills, you will record expenditures in both your business checking account register and on your expense ledger. Your expense ledger will allow you to record the date, check number, payee, check and amount, AND you will assign the expense to a category. The easiest way to categorize your expenses is to use the categories from the federal income tax form for your file.

For example, as a sole proprietor, you will file Schedule C of the 1040 tax form. The categories for this form are:

- Advertising
- Bank service charges
- Car and truck expenses
- Commissions
- Dues and publications
- Employee benefit program
- Insurance
- Interest on business indebtedness
- Laundry and cleaning
- Legal and professional services
- Office expense

- Pension and profit sharing
- Postage
- Rent on business property
- Repairs
- Supplies
- Taxes
- Telephone
- Travel and entertainment
- Utilities
- Wages
- Other

Keeping track of your expenses under these categories will make filing taxes at the end of the year much easier.

These examples use a paper and pencil ledger, but many home-based business owners are using computers to do their record keeping. If you are thinking about using a computer, a good source of information on both hardware and software for small business is *Home Office Computing* magazine. A number of inexpensive software programs are available that include reports such as the balance sheet and income statement.

*A petty cash fund.* A petty cash fund is an easy way to pay for items when the amount is too small to write a check. As you use a petty cash account, you will establish these rules:

- Write a check from your business checking account to start your fund.
- As you spend the money, keep the receipt you receive or fill out a petty cash slip. The information you need on a petty cash slip is the date of the purchase, the item, the amount of the purchase and the expense category.

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Remember that you cannot take a deduction on your federal taxes without documentation.

Petty Cash Ledger		
3/12	Stamps	\$1.30
3/16	C.O.D. charge	1.87
3/17	Office supplies	.53
3/20	Donation to boy scouts	1.00
3/31	Coffee for the machine	3.57

*A mileage log for the use of your personal car or truck.* If you use your personal car or truck for your business, you need to keep a mileage log so you can deduct business mileage on your income tax. Keep a small book in your glove compartment or an index card clipped to your visor. Each time you use the car for business, record the following information:

- The date.
- Beginning mileage.

- Ending mileage.
- Total miles.
- Purpose of the trip.

At the end of the year, it will be easy to total all the miles you have driven for your business. The per mile amount you can deduct changes often, but the federal income tax forms will give you the current amount.

Automobile Log				
Date	Beginning mileage	Ending mileage	Total	Purpose of trip

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*A fixed asset list.* You will need a fixed asset list if you have purchased equipment or office furniture such as a desk or filing cabinets for your business. Unlike business cards or advertising, you cannot deduct the total cost of the equipment as an expense in one year. These must be depreciated over several years. Check with your accountant to determine the number of years you will depreciate each item. You will also need the information on equipment to value your assets on your business income statement.

Keep a record that includes:

- The date the item was purchased.
- A description of the item.
- The purchase price.
- The IRS rule for depreciation. Also note the year you started depreciating the item on your income tax and the method used for calculation.

You will also need this information for your balance sheet and income statements.

## Types of records

You will see that a basic record-keeping system has two types of records:

- Primary records, which include your sales receipts for income and receipts for your expenses, petty cash vouchers and a mileage log for expenditures.
- Secondary records — your check register and ledgers. The ledgers organize your primary records into easy-to-use information for both taxes and management decisions.

## Business reports

You will need two reports to manage your business. The information you have been recording will help you put these reports together.

The first report is a balance sheet. (See example, page 70.) A balance sheet is a report of how much your business is worth. You list the current value of all your assets (equipment, supplies, inventory) and subtract your liabilities (the amount you owe to others). What is left is the capital you have in the business. A balance sheet has a specific date because the value of assets and the amount of liabilities will change.

Let's follow through and ask the questions that this report will answer for you and for any financial advisors you consult. On this date:

- How much cash do you have on hand and in the bank?
- What is the current value of your assets?
- What do you owe in the long and the short term?
- If you cashed out your business today, what value could it have?

The second report you will need to compile is an income statement. (See example, page 71.) An income statement is a report of how much income you received less expenses during some period of time. The time can be any period — one month, a quarter or a year.

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The income statement shows your net profit or loss before taxes for the period. The questions it answers include:

- How much income are you generating?
- How much net profit before taxes did you earn? As a sole proprietor, you are not an employee. You may withdraw from the business (that is, pay yourself) as much or as little money as you want, but this “draw” is not a wage. You do not pay payroll taxes on it and it cannot be deducted as a business expense. You will owe taxes on any amount on the income statement that is left after expenses. For example, if you took a draw of \$5,000 from the business and the amount after expenses is \$10,000, you pay personal income taxes on the full \$10,000. In your expense ledger, you will have a column for non-deductible expenses. The payments to yourself that are written by check are entered in this column. You will need to calculate this quarterly and pay estimated tax returns.
- Are your sales, expenses and profit improving?

Though sales may be going up, if expenses are rising faster you may find that profit is not improving. An income statement tracks the progress of your business.

## Cash flow planning

A cash flow plan, prepared monthly or quarterly, uses the income statement as a base. Though the past does not predict the future exactly, it gives the history on which to base future decisions. Looking at last month's income and expenses will guide your plans for this month. Forecasting helps you estimate your financial needs (how much you need next month to pay your expenses), to prevent surprises, develop short- and long-term goals, monitor your business development against your goals, communicate with lenders and creditors, and obtain capital.

Cash flow planning can help you answer these questions:

- When (what month, time period) does your income come in?
- How will you time your inventory purchases to meet demand?
- How will you time major payments that do not occur monthly, such as insurance?
- How can you do your quarterly estimated income taxes?

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## Balance Sheet

Date \_\_\_\_\_

### Assets

#### Current

Cash	\$ 622.92	
Petty cash	37.00	
Inventory	3,526.18	
<b>Total current</b>		<b>\$4,186.10</b>

#### Fixed

Equipment	\$ 5,400.00	
<b>Total fixed</b>		<b>\$5,400.00</b>
<b>Total assets</b>		<b>\$9,586.10</b>

### Liabilities

#### Current

Accounts payable	\$ 128.40	
Accrued sales tax	56.90	
Income tax payable	100.00	
<b>Total current</b>		<b>\$285.30</b>

#### Fixed

Notes payable, long-term	\$ 2,500.00	
<b>Total fixed</b>		<b>\$2,500.00</b>
<b>Total liabilities</b>		<b>\$2,785.30</b>
<b>Total capital</b>		<b>\$6,800.80</b>

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## Income Statement

ZZZ Company — A sole proprietorship      Date \_\_\_\_\_ to Date \_\_\_\_\_

### Income

Gross sales	\$ 4,690.10	
Less returns	124.10	
Total cost of sales	\$ 4,566.00	
<b>Gross profit from sales</b>		<b>\$ 4,566.00</b>

### Less operating expenses

Advertising	\$ 216.00	
Bookkeeping	100.00	
Travel	263.00	
Insurance	200.00	
Miscellaneous	200.00	
Office supplies	48.00	
Petty cash	63.00	
Supplies	1,250.00	
Utilities	147.00	
<b>Total operating expenses</b>		<b>\$ 2,487.00</b>
<b>Net profit before taxes</b>		<b>2,079.00</b>

Estimated taxes (personal income taxes on the net profit before taxes)





## Adding to your record-keeping system

As your business grows, you may need to add to your record-keeping system. Some additional items that may be critical include:

- Order forms.
- Receipt logs.
- Inventory records.

### *Order forms*

An order form is a standard way for customers to buy your products. An easy way to start thinking about your order form is to look at the forms included in the catalogs you receive. Most will include:

- The date of the order.
- The quantity and description of the items desired, as well as the price.
- The delivery method and the cost. There are a number of ways to determine delivery cost. One is to calculate by weight and shipping location; another is by the dollar amount of the purchase.
- The total dollar amount.
- Sales tax, if applicable.
- The total cost, including delivery cost and sales tax.
- Method of payment — check or credit card.

You can use an order form from an office supply store or you can print your own. Order forms can be included in advertising,

brochures and catalogs, or your mail-order program.

### *Receiving logs*

As the quantity of merchandise or supplies coming into your business increases, you will need a system to check shipments received against the orders you have placed with your suppliers. A receiving log will help you check in an order and give you a place to note incorrect items, items not shipped or incorrect quantities. You may wish to attach “receivers”, slips of paper noting any differences, directly to your purchase order or the supplier’s invoice. You can then check these notes and notify the vendor before you pay the invoice.

### *Inventory records*

If you are selling items at retail or have supplies and materials that you need to make your products or offer your service, you will need an inventory system. The first level of taking inventory is called “eyeballing” — looking around to see what you need to order. As the number of items grows, however, this system will not be adequate.

You may develop two types of inventory systems:

- The first is to record the items sold or used and subtract them from your beginning inventory. A simple inventory sheet is handy for this type of inventory control. This perpetual inventory can give you a good idea when to reorder and eliminate the need to count each item.

# Home-based Business – Record Keeping

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## Perpetual Inventory Record

ITEM _____		COST _____		SUPPLIER _____			
<u>Ordered</u>		<u>Received</u>					
Quantity	Date	Quantity	Date	Sold		Balance	
50	1/31					0	
15	1/31	35	2/13			35	
				<del>III</del> <del>III</del> III		22	
				III		18	
		15	3/1			33	
				<del>III</del> <del>III</del>		23	
				II		21	
50	3/12						

You may want to date when the item is received so you can tell the age of your inventory.

- Semi-annually or annually, you may want to count all the items. The perpetual inventory is an easy way to keep a running count of your supplies or merchandise, but a physical count may also be necessary. You will want an actual count before completing a balance sheet.

In a physical inventory, include a good description of the item, the number you have in stock, price and total value. The total value of your inventory is listed as an asset on your balance sheet.



## Extending credit

Whether to extend credit to your customers is a decision you will consider as you plan your business operations and set policy. You may find that in the beginning, you prefer to handle only cash sales (cash includes checks). As your business grows, you may find that to increase your sales and keep up with your competition, you will need to offer a credit option.

Extending credit on your own is a large financial commitment. It not only means that you must wait to receive payment, but you must also figure the costs of bookkeeping, accounting, collection and interest on your outstanding income. Most home-based business owners find that using a national charge or credit card is simpler and less expensive. With a national card, you turn over the bookkeeping, collection and accounting services to a company for a fee.

National cards available include:

- American Express
- MasterCard
- Visa

Your financial institution is one place to start if you are interested in MasterCard or Visa. Though these are national companies, they sell their services to financial institutions, not directly to the business owner. You will sign an agreement with the financial institution that will tell you:

- How to handle charges and fill out the forms.
- How to handle credits and returns.
- How to verify credit approval.
- How you will be reimbursed.
- The fees that you will pay for the service.

Usually you will deposit your charge sales slips with your cash and check deposits. The total amount will be credited to your checking account. At the end of the month, you will be billed a percentage of your gross credit sales as your fee for using the service.

Following the verification rules is important for making sure that you do not accept a charge from a customer who is no longer a valid user of the card. This is obviously very difficult if you are selling from a location without a telephone, so you will have to consider carefully what policy you will follow.

American Express is different from the others in that you work directly with a representative from the company. If there is no phone number in your local telephone directory, call the national WATS line information operator at 1-800-555-1212 to obtain the closest toll-free American Express number.

The representative will explain the American Express system. Unlike Visa and MasterCard, you will mail your sales receipts to an American Express office, which will send you a check for the amount of your sales less a service charge.

# Marketing



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# Home-based Business – Marketing

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Once you have determined what business you are starting, you will need to start developing your plans to market your product or service. Marketing is the process of getting the product or service from you, the producer or provider, to the customer. Marketing is often defined as determining the four P's: product/service, promotion, place and price.

## *Product/service*

Your product or service needs to be clearly defined. You must determine whether you are selling a unique item or service to a select number of customers, or providing a product or service that appeals to a broad number of people.

## *Promotion*

How will you let your customers know about you and your product or service?

## *Place*

Where is your market located? Will customers come to you or do you have to go to them?

## *Price*

Pricing is probably the hardest part of marketing. Determining your price will affect not only your sales but your profit level as well.

This chapter deals with product and place. The next two chapters deal with promotion and price.

## Identifying your customer

### *Target marketing*

The total market can be subdivided into distinct groups of buyers who might respond to a

product/service or marketing mix of products and services. Each market segment needs to be evaluated to determine its potential. Then one or more segments are selected. A mix of products or services is designed for each of the chosen segments.

A starting point is to determine if you are marketing to consumers or businesses.

## *Consumers*

You can segment consumers in many ways. Here are three suggestions:

### 1. Demographics

*Age* - The fastest growing market in the United States today is the consumer over the age of 55. The largest market in numbers continues to be the baby boom generation (born between 1946 and 1963).

*Gender* - There are some differences between what men and women buy.

*Ethnic groups* - Within our communities are many ethnic groups. We are becoming a nation of minorities. "The engine driving the increase in ethnic diversity is the relative youth of minority populations."<sup>1</sup>

*Income* - Socioeconomic differences are important not only because families with more money spend more, but because they spend money on different types of products and services. But remember, all income groups buy products and services.

<sup>1</sup> Rossman, Marlene L. 1994. *Multicultural Marketing: Selling to a Diverse America*, Amacom, pg. 4.

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*Occupation/hobbies* - Understanding a certain occupation or hobby will help you to determine specific needs of people engaged in that activity.

## 2. Time of use

Are there life events that make the use of this product or service more important? Life events may be birth, graduation from school, marriage, purchase of a first home, divorce, children leaving home, grandparenting, retirement or death.

## 3. Use of your product or service

Think about your customers and place them on a sliding scale rating how much they might use your product or service. Are most of them naive about your product or service? Are they regular users who are quite knowledgeable and are repeat buyers? Or are they experts who know almost as much as you do about the product or service?

← Naive — Regular users — Experts →

The need for information and education among these three groups may be very different. Think of information as education. As you analyze the need for education, you will begin to establish your marketing approach.

Example for naive users:

If you are trying to sell tofu to a group of customers who do not know what it is, you

would need to provide many types of information. First, you would need to define tofu (a bean curd used as a protein substitute in cooking). You might use signs/displays where the product is sold to describe how tofu can be used. A brochure with recipes might be helpful. The label on the package might carry a recipe. You might have a food tasting in a store that sells your tofu. You might write an article for the local paper on the health benefits of tofu as a non-fat source of protein.

Example for regular users:

If you run a bookkeeping service, you might think that most of your customers understand the services you offer. You could, however, make a list of all your services and include that list in a mailing, brochure or display ad to jog their memory. You could also use quotes from satisfied customers to illustrate your expertise. Or you could quote how much a customer has saved using your bookkeeping service.

Example for expert users:

Experts who may know as much as you do about the use of the product will be very receptive to new uses or new information. A newsletter can serve that purpose. Or you can pass along tips on successful uses by other customers. A class or demonstration of how to get the most out of the product or service can help you see what problems customers might be having.

# Home-based Business – Marketing

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## Businesses

For business customers, you can segment the market by determining:

- Industry. Does your product or service serve one particular type of business?
  - Retail businesses.
  - Service businesses.
  - Manufacturing businesses.
- Size of company. Is your product or service needed by small, medium or large companies?
- Corporate function. What area of the company needs your product or service — finance, sales, personnel, training, purchasing? Who makes the purchasing decision?

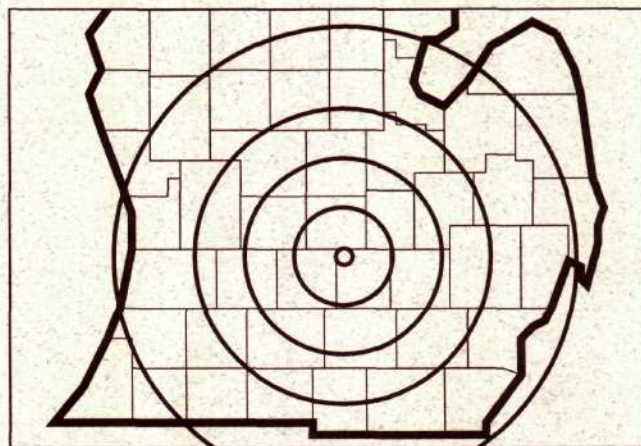
## Geographic area

Regardless of your target customer, you need to define your territory. Most small businesses must determine how large a geographic area they can serve. A product business or an information service business can reach a much larger geographic area than most service businesses. Mail, both regular and electronic, allows for easy communication across the country. But the question to be asked is: how much it will cost to reach the customer with advertising, fill orders and service customer needs? The larger the geographical area, the more money it will cost.

On the other hand, if you have customers with very specific targeted needs, you may need to cover a wider geographic area to build a cus-

tomers base large enough to support your business.

- Neighborhoods - possible in urban areas.
- Towns or cities.
- Counties or state.
- Regions of the country.
- National.



The geographic area you serve may vary in size.

## Marketing worksheet

1. After you do your research, use this checklist to determine which characteristics best fit your customer. Then develop a customer profile statement by checking the boxes that describe your customer.

Geographic market area

\_\_\_\_\_

Demographic characteristics

- Age \_\_\_\_\_

- Gender \_\_\_\_\_

- Ethnic groups \_\_\_\_\_

- Household income \_\_\_\_\_

- Occupations/hobbies \_\_\_\_\_



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- Time of use
  - Birth \_\_\_\_\_
  - Graduation \_\_\_\_\_
  - Marriage \_\_\_\_\_
  - Home purchase \_\_\_\_\_
  - Divorce \_\_\_\_\_
  - Retirement \_\_\_\_\_
  - Death \_\_\_\_\_

- Extent of use
  - Naive user \_\_\_\_\_
  - Regular user \_\_\_\_\_
  - Expert \_\_\_\_\_

2. Write a 25-word statement describing your customer.

Who is my customer? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

## Market research

Research can be easier than you think and can be accomplished in several ways. Here are some steps for you to follow:

### *Primary research*

Talk with your potential and actual customers by finding people who fit your customer pro-

file. Ask questions about your product or service that will give you clues about what they want and how they view what you offer. One technique is a focus group. A focus group is typically composed of seven to 10 participants who are not familiar with one another. The rule for selecting the participants is commonality, not diversity. You need to record responses to the questions you ask about your product or service, but you do very little talking after your introduction. Determining the questions in advance is the critical part. Most focus group participants are offered some incentive to participate, such as a sample of your product or service.

Another technique is a want list. As your business starts and grows, keep a list of comments you hear from customers. It may be direct questions, such as "Do you have this in .....?" Or it may be comments you overhear in places where you sell your product or deliver your service. This list can help you understand a changing market.

### *Secondary research*

Trends help you define what's happening to your customer within your industry.

#### *Customer trends*

Your local library has statistics from census data on population, age, income and occupation in your defined territory. Ask your librarian to help you find:

- U.S. Department of Commerce
- Statistical Abstract of the United States*
- Current demographic and economic statistics

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for state, county and metropolitan areas, including retail expenditure data and estimates of buying power.

## *Census of Manufacturing Trade*

## *Census of Wholesale Trade*

## *Census of Retail Trade*

## *Census of Selected Service Industries*

Surveys of major business types in city and state tables, business volume, number of establishments, payroll and employee size, and other related financial data.

## *Census of Housing*

Who lives where, by number of individuals, economic status, racial composition, type of home.

## *Survey of Current Business*

Monthly updates on the performance of leading economic indicators on national, state and regional bases.

## *Survey of Buying Power - Sales and Marketing Management*

Comprehensive data — housing, population, manufacturing, construction, wholesale and retail statistics.

## *Market Profile Analysis*

Current statistics — retail market indicators, new housing construction activity and financial institution data.

Your local Chamber of Commerce may have demographic information on your community.

**Industry trends** — Though you may not view your business as part of an industry, there are other businesses like yours in your geographic area and around the country.

Contact the Small Business Administration (SBA) for help or enlist a member of SCORE (Select Core of Retired Executives) to act as a consultant.

Find a trade association. Trade associations help businesses join together and share information. Consult the Gale Encyclopedia of Associations in your library to locate the trade association that most closely fits your business. Trade associations keep a finger on the pulse of trends in your industry.

Suppliers and wholesalers who sell to you also sell to many other small businesses like yours. They have contacts in a wide variety of locations.

## *Competition*

Evaluate your local competition and, if possible, competitors in a wider geographical area. Use the yellow pages or other directories as a first source of information on your competitors. Who are they? What do they have to offer? What are they missing?

### *Rating the competition*

**Product strategy** — What do your competitors have to offer? What kinds of products or services do they offer?

**Place strategy** — Where are your competitors located? Do they have a location that customers go to? If they participate in shows,



what does their display space look like? How do customers reach them?

**Price strategy** — How do your competitors price their products or services? Do they have a variety of price points? How important is price to your target customer?

**Image** — What is your competition's image? Image is based on everything a firm is and

everything it does. How would you, as a customer, view this business?

**Promotion strategy** — How does the competition communicate with its customers?

**People strategy** — How does your competition treat its customers?

**Differential advantage** — Can you identify any combination of things that gives your

## Rating the Competition

*Describe the target market:*

Competition comparison	Competitor 1	Competitor 2	Competitor 3
1. Product strategy			
2. Place strategy			
3. Price strategy			
4. Image			
5. Promotion strategy			
6. People strategy			
7. Differential advantage			
8. Summary			



competition an edge in serving a particular market? Is it image, product or service, product mix, additional services, unique advertising, price? Why do people buy your competitors' product or service?

**Summary** — Summarize the information that you find about each competitor. How do you compare?

## Marketing questions

As you conduct your market research, find the answers to the following questions:

1. Does anyone need or want your goods or services?
2. If the needs or wants aren't established, can you establish them?
  - What problems do your customers have?
  - What questions are they asking?
  - What can you do to help?
3. Is the population of customers large enough to support your business?
4. Do your goods or services fit the market and fill a niche in it?
5. Has your competition already filled the market? What are the strengths and weaknesses of your competition?
6. What advantage do you offer? This is the most important question. Why would a customer come to you rather than someone else? It could be selection, quality, uniqueness, personal advice or price.

## What is your business?

Now that you have researched the market, define your business in words that your customers will understand. Look at this example:

One woman who started her business after her graduate training called herself a therapist. This did not generate business because no one understood what she did. So she developed this description:

"I help successful executives or business owners who have short-term emotional problems such as divorce, family stress or trauma."<sup>2</sup>

## Create a name for your business<sup>3</sup>

A business name should be short, unique and easy to remember. Some choices in naming your business include :

*Your name.*

Example: G.G. Bean, Inc.

Pro: useful when you are the business, such as a consulting service.

Con: doesn't tell who you are or what business you are in.

<sup>2</sup> Phillips, Michael, and Salli Rasberry. 1986. *Marketing Without Advertising*. Berkeley, Calif.: Nolo Press, p. 7:3.

<sup>3</sup> Edwards, Paul; Sarah Edwards and Laura Clampitt Douglas. 1991. *Getting Business to Come to You*. Los Angeles: Jeremy P. Tarcher, Inc., p. 60.

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*Your name along with what the company does.*

Example: C. B. Behrman Photography.

Pro: lets people know who you are and what you do; often used by professionals.

Con: limits you to that particular business — you cannot expand into other areas.

*A name that communicates the primary benefit.*

Example: Affordable Word Processing.

Pro: your name is your ad, conveying your key benefit.

Con: you have to live up to your name, and it may limit expansion possibilities.

*A description of the company's main activity.*

Example: Class Reunions, Inc.

Pro: allows you to communicate exactly what you do.

Con: can limit your expansion into other areas.

*A made-up name.*

Example: Vericomp.

Pro: useful if your business does several things and you want an umbrella name.

Con: doesn't tell who you are or what you do.

## YOUR NAME?

From your market research and your customer profile, write a statement of 30 words or less that defines your business.

Business name: \_\_\_\_\_

Business description: \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Overall, my business is different and unique because: \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

## Marketing channels

What marketing channels will you use?

1. Producer direct to the consumer. This is the easiest and most common for home-based businesses. It is the only possibility for most service businesses.
2. Producer to retailer to consumer. You may sell directly to a retailer or place merchandise on consignment.
3. Producer to wholesaler to retailer to consumer. Some home-based business owners are finding that a sales representative who sells to retailers is an effective way to market.

## Marketing your service

Though the basic marketing strategies are identical for products and services, differences do exist between products and services. Services possess some distinctive characteristics that can affect marketing. Services are often intangible — they often can't be touched, smelled, felt or seen until they are completed. You must concentrate on the benefit received from the service. Giving your customer a satis-



fyng experience is what good service is all about.

Services cannot be separated from the seller. Often a service is created, marketed and used at the same time — for example, a beauty operator or barber cutting your hair. The quality of the service depends on the skill of the provider. There must be a close relationship and good communication between the provider and the customer.

Services cannot be stored. Business is lost forever when the service is not performed, since time becomes the limiting factor. Planning your time is the most important factor. In a service business, the hours you spend with customers must be your most valuable hours. Determining the best hours for your customers is a critical part of a successful service business. Other business tasks such as book-keeping, planning, advertising or inventory control must be done at other times.

## How to develop a questionnaire

“Ask and ye shall receive.”

An old saying advises, “Give people what they want. They will love you for it and come back for more.”

That’s just what your business needs to survive, but to keep customers coming back, you must determine what they really want. How do you do that? Discover what services are satisfactory, where improvements are needed, where services are lacking. Your profit and

loss statement may tell you when a service is not attracting customers, but it cannot tell why. Nor will the profit and loss statement indicate if a new service will be profitable.

Your customers can tell you that and more. Ask them in a way that makes it easy for them to tell you. Design a questionnaire that will not impose on their time or their patience and that will promise them some hope of affecting the services they receive from you (and maybe other, more tangible rewards such as discounts on services already in place).

- Keep it simple.

In constructing your questionnaire, use everyday words. Avoid ambiguous or technical terms and phrases. Try not to lead the reader to the answer you want. For valid results, ask simple questions seeking honest answers.

- Keep it easy.

Successful questionnaires use boxes to be checked and numbers to be circled. They also use questions that are worded so that the customer can give clear, easy answers. The quicker the questionnaire can be filled out, the greater the likelihood of response.

- State your purpose.

One of the first items on a survey should be a statement of its purpose, kept brief and to the point. Emphasize the customer needs you are hoping to discover.



- Be positive.

Though it is not advisable to slant the questions, it is better to be positive. First ask about the kinds of services that are obvious winners. After that, try to identify felt deficiencies and areas that need improvement.

- Use an “other” option.

In case you overlooked an idea, always include a category labeled “other” or “miscellaneous” with space for respondents to develop an answer or make other comments. Few people will use this category, but those who do will make valid comments.

Action is critical if you plan to conduct additional surveys. If you don’t use the results, it will be more difficult to gain cooperation later.

- Follow up.

Once you know your major strengths and weaknesses, you can focus on them and conduct additional surveys to determine the pluses and minuses of other services that will round out your package.

It is wise to review your business operation critically every year. Monitoring your operations systematically can prevent a minor problem from developing into a disaster.

Developing questionnaires and conducting surveys consume time. The results may be startling. Only those willing and able to analyze and act should undertake the project as a method of monitoring. The benefits, however, usually outweigh the cost. Letting customers tell you what they want and giving it to them will keep them coming back.

## Selling by mail order

Just the words “mail order” can fire up the imagination and ignite the enthusiasm of any entrepreneur! It can be an effective, inexpensive and profitable way to sell.

Your success depends on carefully planning each segment of your venture. An eminent mail order entrepreneur, professor and consultant recommends researching the mail-order business at your local library before you launch your business.

### *Some areas you need to research*

- Federal regulations on mail-order sales.
- Use of media, such as magazines, catalogs, television and direct mail.
- How to calculate costs.

### *Some excellent books*

Bond, William J. 1993. *Home-Based Catalog Marketing*. New York: McGraw-Hill.

Kremer, John. 1990. *Mail Order Selling Made Easier*. Fairfield, Iowa: Ad-Lib Publications,

Simon, Julian L. 1987. *How to Start and Operate a Mail Order Business*. New York: McGraw-Hill.

### *A source of information*

Direct Mail/Marketing Association, Inc., 6 East 43rd St., New York, NY 10017.

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With some background under your belt, you should then determine the types of products or services that sell well by mail by studying trade publications, attending product shows, contacting manufacturers and answering ads.

## *What is the best possible product or service?*

Consider this checklist:

- High quality product or service.
- Unique product.
- Product not available at local stores.
- Product that can be used by a broad group of customers or a very targeted group.
- Product easy to store.
- Product easy to mail.

## *How to get mailing lists*

You can either buy a mailing list or build your own. To purchase a list or lists, check the telephone directories of large cities. Many types of lists can be purchased, including lists of people having some characteristic in common (maybe a location you are trying to reach, a certain level of education, etc.) and lists of people who have purchased something from a particular mail-order firm.

Information on purchased lists is available in this book at your local library:

Direct Mail Rates and Data  
Standard Rate and Data Service  
5201 Old Orchard Road  
Skokie, IL 60076

Also, check your library for a copy of the following:

Burnett, Ed. *The Complete Direct Mail List Handbook*. Englewood Cliffs, N.J.: Prentice Hall, 1988.

National Directory of Catalogs. Oxford Communications.

You can build your own list in several ways:

- Ask customers to sign a guest book.
- Have a drawing and ask for a mailing address on the drawing ticket.
- Write names and addresses of customers on sales slips.
- Take names and addresses from checks that you cash.
- Ask people if they want to be on a mailing list for notification of sales, special events and other promotions.

## **Selling at open air markets, fairs and trade shows**

Take your wares to festivals, fairs and flea markets where you can enjoy the holiday atmosphere and have a profitable day at the same time! Or become an exhibitor at a trade show. When you decide to join the show circuit, you know you'll be competing with lots of other ambitious entrepreneurs. How can you capture your fair share (or more) of customers?



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Getting people to stop and look at your products is the first step in selling at shows. That's what displays encourage. The stronger the display, the more attention you will attract.

Consider these basic suggestions.

- Show light merchandise on a dark background and dark against light.
- Keep the background simple so people will focus on your product rather than on the display.
- Use a minimum of signs and posters.

Use gimmicks to attract attention. For instance, encourage people to stop by putting a mirror in your sales area. Most of us can't resist a glance, and the odds are good that we'll also glance at your products. Another successful gimmick is a guessing contest, with a prize for the winner, or a box for entries in a drawing for one of your products.

Putting action into your display is a surefire way to attract attention. Any slide or movie presentation will draw prospective buyers to you. If you're selling fashion items, have someone model them. If you're selling fishing equipment, show fish in an aquarium. If you're selling auto accessories, bring along a small racetrack. If your gimmick moves, it can increase your sales dramatically, so plan to put some action into your act before you take it on the road.

Remain standing and interact with people who pass by. Don't sit passively by waiting for someone to initiate the conversation.

Keep a file on every show you attend. Write down all the details about the show and your

part in it. Specifically, the record should include all fees paid, round-trip mileage, lodging, meals and incidentals, such as tape, supplies and marking pens. Use a credit card or ask for a receipt for all purchases.

One major expense most people forget is their time. Knowing how many hours you spend traveling, setting up and dismantling your display, and selling can help you decide if attending a show was worth the cost. This information is a tool to help price your wares. The cost of paying someone to "mind the store" while you were away is another factor to note and consider.

The most important component of show records reports what you sold. Certain products may sell better at certain shows or at various times of the year. These records can identify such trends.

If you attend more than one show per season, it might be a good idea to keep a separate file on each one. Summarize on a single page total expenses, income and hours spent to help you compare shows and decide which ones to attend another year.

## *For information on fairs and shows in Michigan:*

1. Send a self-addressed, business-size envelope stamped with two stamps to the Michigan Council for the Arts, 1200 Sixth Ave., Detroit, MI 48226 for a directory of shows and fairs.
2. Get festival information from the Michigan Travel Bureau. Write to Dept RTA, P.O. Box 30226, Lansing, MI 48909.



3. For information on trade shows and conventions, check these publications:

Directory of Conventions. Successful Meetings, Inc., Bill Communications, Inc. 633 Third Avenue, New York, NY 10017.

Trade Show Bureau. Box 797, East Orleans, MA 02643.

Trade Shows and Professional Exhibits Directory. Gale Research Inc., Book Tower, Detroit, MI 48226.

Tradeshow Week Data Book. Tradeshow Week. 12233 West Olympic Boulevard, Suite 236, Los Angeles, CA 90064.

## Selling on consignment

Selling on consignment means taking your product to a business person who pays you only after the merchandise is sold. Advantages of this arrangement include increased visibility for your product plus the possibility of a reciprocal arrangement and lower overhead.

For example, a friend runs a successful sculptured nail/manicure business in her home. She sells clothing, silk flowers and other handcrafted items and promotes local hairdressers and florists. In return, these entrepreneurs display her business cards, talk to their customers about her expertise and include her in their advertising. The network operates like an informal chamber of commerce where everybody benefits.

Conversations with consignors and consignees reveal a wide variety of selling arrangements. Merchants may agree to keep goods on consignment for 90 days to well over six months and to take a 25 to 40 percent markup. Others take nothing but do it for the public relations value. So, shop around for the deal that suits you best.

### *Ask a number of questions before agreeing to sell items on consignment:*

- Will the shop's insurance pay for fire or theft losses? What happens if a handcrafted item is accidentally broken while on display?
- Will there be a written consignment agreement defining your responsibilities and those of the shop owner? There should be! It should include a description of the products offered for sale, the prices and the percentage the shop retains, and it should specify whether the shop owner can sell an item for less without first asking your permission. Are you required to work in the shop?
- How will the selling price be divided between the two parties?
- How often will payments be made?
- How often will unsold merchandise be returned? Are you responsible for picking it up, or will it be mailed to you at your expense?

All these points should be spelled out in your written agreement.



## *Consignment has the following advantages:*

- You can consign merchandise of your choice without the pressure of a deadline.
- You can test the marketability of your new or untried items.
- You can control the retail price of your items.
- You can concentrate on producing rather than selling.

## *It has some disadvantages, too:*

- You have to wait for your money until the item is sold.
- Because you have no control over the place to which you consign goods, you cannot control damage or shopper abuse or the image of other consignment shop products.

- You will probably find yourself dealing with increased bookkeeping and paperwork. It is very important to keep careful records and get all agreements in writing.

Consider consigning to stores that will display a large selection of your products in a wide range of prices. The presence of the higher priced items will encourage the sale of the lower and medium-priced items, and the variety will show how versatile you are.

Promote the shop that is handling your work by printing inexpensive fliers saying your work can also be found there. Hand out the fliers when customers come to your home, insert them into mail orders, and display them in your exhibit when you attend shows and fairs.

Use the sample forms on following pages as a starting point. Use the sample inventory sheet as your list of products consigned to a particular shop. The sample agreement shows all the items that must be covered. It can be modified as needed.



(Sample)

## Consignment Agreement

Date: \_\_\_\_\_

1. Artist: Name \_\_\_\_\_  
Address \_\_\_\_\_

2. Consignee: Merchant's name \_\_\_\_\_  
Address \_\_\_\_\_

3. Artist does hereby consign to consignee the following articles:

Item description/quantity	Retail price
a. _____	_____
b. _____	_____
c. _____	_____

4. Consignee agrees to use its best efforts to sell such art works at the prices listed above.

This agreement is for an indefinite term and shall terminate on \_\_\_\_\_ days written notice by either party. On notice of termination, consignee shall surrender all works of art to artist and shall remit to artist all sums which shall be due under this agreement.

5. Consignee shall be entitled to a commission of \_\_\_\_\_% of the sales price of works of art sold. Sales price does not include cost of delivery, costs of collection of accounts receivable or taxes on such sale.

6. Artist shall be entitled to payment of the sales price by consignee of such works of art as are sold by consignee, less commission as stated above, within 30 days after any such sale.

7. Artist shall deliver works of art to consignee at artist's risk. Upon such delivery, consignee shall consume all risk of loss until such art work has been sold and delivered, or returned unsold to artist.

8. In the event that consignee fails to timely remit such sums as are due and owing under this agreement, consignee agrees to pay reasonable attorney's fees for collection of such sums.

\_\_\_\_\_  
Craftsperson signature

\_\_\_\_\_  
Merchant signature

Reprinted from "Marketing Crafts: How and Where to Sell" by JaneAnn Stout and Diane Nelson, Iowa State University, NCR 175, May 1990.





## Selling through sales representatives

If you are busy making a product, the time it takes to sell it may make for a very long day. As your ability to produce a proven product increases, you may want to consider turning over the sales responsibility to a sales representative. This usually happens when your volume increases to a point where you cannot do everything yourself.

Sales reps provide a way for you to keep time and money costs down and still have someone working full time to bring in business. A sales rep will usually handle the line of several producers in a specified territory on a commission basis. You will want to make sure that the representative is not carrying a competing line and that the types of stores he/she calls on are the best locations for your products line.

Generally a sales representative will be either an independent who travels to buyers and stores or an employee of a firm that has a permanent showroom. The amount of commission varies according to the products but is usually between 10 and 25 percent. Fifteen percent is a very common figure. In most cases, the sales rep pays for his/her own expenses.

Finding a representative that you are comfortable with takes some time and effort. Start by:

- Checking the yellow pages in larger cities under "Manufacturer's Agents and Representatives."
- Asking people in a similar business for possible leads and also checking the ads in trade magazines.
- Contacting one of the Merchandise Marts — in Atlanta, Chicago, San Francisco, Dallas (World Trade Center) and Los Angeles (Pacific Design Center)— or the Gift Mart in Northville, Mich. Visiting one of these permanent showrooms will also give you a good idea of who sells what.
- Checking with the owners of the types of stores where you want your product sold. They may know of some good representatives who could handle your product line.

Before hiring, be sure you ask for and receive references. Once you have references in hand, use them! Contact other producers to see how satisfied they are with the representative.

What are your responsibilities when you work with a sales representative? Here are some points to consider:

- Put your agreement in writing, including the territory, commission and payment terms.
- Keep in touch with your rep. Alert him/her to any changes in your product line, including new products, products that you have dropped and price changes. If your production schedule on any item changes, be sure your rep knows so he/she doesn't write an order for a deadline that you can't meet. Know your production capacity and clarify with your rep how much you can produce in what period of time.
- Supply your rep with samples, catalogs, pictures or anything else that will help him/her



sell your product line. This may mean a color catalog or brochure, catalog sheets or a professional 8 x 10 photo of your work. Usually sales reps do not pay for the sample line, so this is an additional expense that you must carry. Present yourself as a professional by using business stationery.

- You may want to send out confirmation orders to customers before filling and shipping orders placed by your rep. This avoids any opportunity for a misunderstanding.

Working with a sales rep may be less hassle than hiring a sales employee. The effort you put into selecting the right person will pay off in the long run.

Tips for working with a rep:

- Be sure your product is finished in a professional manner, has high consumer demand and can feasibly be produced in volume. Do not copy products already in the marketplace. Do something different or better than what is currently available.
- Work with a rep with whom you can communicate. Take nothing for granted. Work out problems before they happen.
- Once you have started working with a rep, listen to him/her and the information you get. A professional rep is out talking to your customers every day and can keep you alerted to changes in the market, customer taste and your competition.

*Adapted from:*

Olson, Sharon K. "Selling Crafts Through Sales Reps." National Home Business Report, Vol. VIII, No. 2.

## Selling retail

Operating a small retail shop from your home or expanding to main street has been the dream of many beginning entrepreneurs. Or once you've successfully sold at fairs or through a consignment shop, you might be thinking about opening a shop as the next step. Today retail competition has increased with mail-order catalogs with 800 phone numbers, mega-stores, and TV and computer shopping.

### *Economic and retail trends*

An Arthur Andersen study of retailing cited the following points that affect the state of retailing today.<sup>1</sup>

- Industry consolidation — Large retailers are exerting tremendous pressure on the marketplace. "As the big retailers get bigger, they infiltrate and even dominate small towns. Sadly, in many cases, the need for small store retailers diminishes."
- Overstoring — There are still too many stores. The side effects are shifts in shopping patterns and more options for customers, and small store loyalty is being tested.
- Value-conscious customers — Customers are looking for price value as well as product quality. Small retailers need to carefully evaluate their market niche, merchandise assortment and pricing strategies.

<sup>1</sup> Arthur Andersen. April 1994. Small Store Survival: Success Strategies for Illinois Retailers, Illinois Retail Merchants Association, Chicago, pg. 5-6.

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- The changing population — The population is getting older. By the year 2000, the entire baby boom population will be between the ages of 36 and 54. Over the next 20 years, the minority population will expand rapidly.
- Shrinking labor pool — The younger labor pool is not growing as quickly. This has traditionally been the labor pool for small retailers. Scarce labor will increase labor costs.
- Time-constrained customers — More American families have less time to shop. Customers will be less likely to shop many stores. Small retailers need to target the right customers.

So a small retail store needs to develop a market niche and a special image. Many business owners will tell you that 20 percent of their customers are responsible for 80 percent of their sales. You have a great deal of influence over the image the business projects. As a small retail owner, you are usually the salesperson that customers meet.

It is important to create a good first impression because many customers will not give you a second chance. Most of your dealings with customers hinge on good manners and common sense, but it is surprising how many people need to be reminded of both.

The first sign of welcome that a customer should see is a smile. A welcoming face makes a customer feel comfortable and at ease. A cheerful greeting may determine whether you make a sale.

The appearance you present is very important. Most people appreciate a well groomed salesperson. How you dress should be determined by the type of store. If you are selling fashion items, you might want to consider wearing some of the merchandise.

You are in a business to serve the customer. Most customers don't like to wait, but they will as long as it appears every effort is being made to take care of them. Problems arise when the salesperson is not taking care of business.

Everyone is not a master conversationalist, but friendliness is a quality you can build. It takes practice to feel at ease with a variety of people. But a good salesperson must be able to make small talk. The basic ingredient is a genuine interest in people. Most people respond positively to the simple "How are you?" Why not give some information about your products or service that may not be obvious?

Eventually someone will be unhappy with your product or service. How will you handle the complaint? What procedures do you have established? Will you repair a defective product or must you find someone else to do it? Most people are reasonable to deal with if they see you are trying to do your best to correct the problem.

It is vital that you set policies and goals for the operation of your business. It is well worth the time and effort to talk to people in similar businesses and find out how they handle various situations.



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To develop good customer relations, you must establish business rules, policies and goals. If you hire employees or ask someone to help you, he/she must know what you expect.

- What is the refund/return policy?
- What are the procedures for cashing a check or writing up a charge?
- Will you hold an item for a customer? How long?
- Do you give a discount if the customer purchases many items?

Questions like these will be coming up constantly at the beginning of a retail business. Some may seem very minor and petty, but they all affect the atmosphere and image of the business.

Good products and competitive prices are one aspect of a successful business. As the retail owner, your primary job is to make sure that customers are treated in a way that ensures that they are happy and satisfied customers.

## Exporting/global marketing

You have your business started and you are ready to consider exporting. Two points you need to consider are: do you have some financial security — that is, you need to be able to commit funds to the development of an export market plan, redevelopment of product and/or product literature, etc.; and commitment — how committed are you?

Once you've determined that you have commitment and financial security, what do you need to do and where do you go for information?

The Michigan Technical Assistance Centers (MTAC) are a statewide network that can help you assess your business's export potential, competitors and opportunities in the global marketplace. Some centers may charge a fee for this service to the business.

Technical export assistance includes:

- Evaluating business readiness to export.
- Identifying countries with a market for your product or service.
- Developing market entry strategies.
- Accessing computerized matching of international trade leads with company products or services.
- Sponsoring training workshops.
- Coordinating international trade show participation.
- Providing support on documentation, shipping, financing and legal requirements.

The Michigan Technical Assistance Centers help businesses determine their capabilities, constraints, goals and objectives. The trained professional can introduce businesses to federal and state agencies as well as private sector businesses that can provide valuable resources such as international financing, transportation and cultural information.

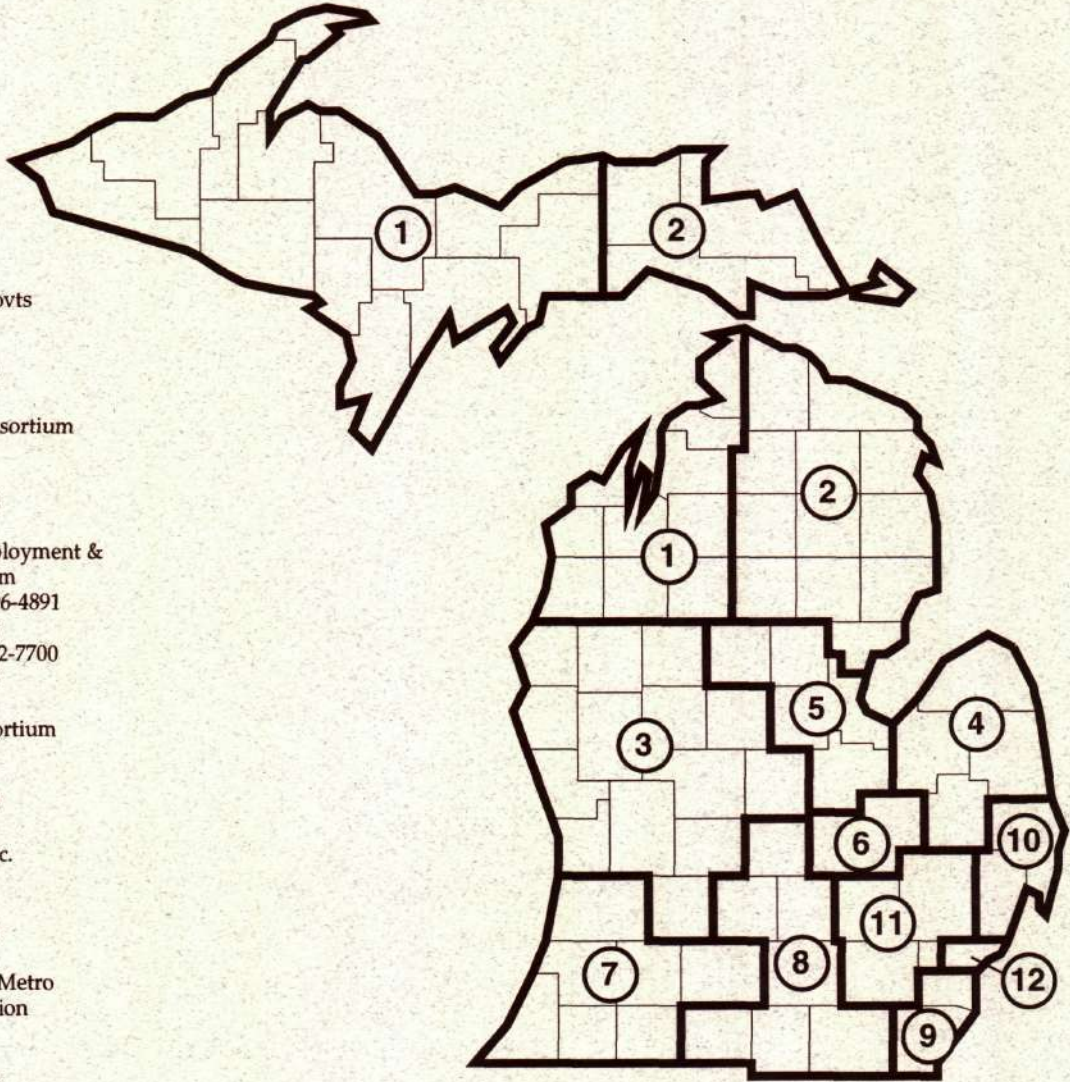
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Locations of the centers are:

## MTAC Network

- 
1. N.W. Council of Govts  
Traverse City, MI  
(616) 929-5000  
FAX (616) 929-5012
  2. N.E. Michigan Consortium  
Onaway, MI  
(517) 733-8548  
FAX (517) 733-8069
  3. W. Central MI Employment & Training Consortium  
Big Rapids (616) 796-4891  
FAX (616) 796-8316  
Muskegon (616) 722-7700  
FAX (616) 722-6182
  4. Thumb Area Consortium  
Marlette, MI  
(517) 635-3561  
FAX (517) 635-2230
  5. Saginaw Future, Inc.  
Saginaw, MI  
(517) 754-8222  
FAX (517) 754-1715
  6. Genesee Country Metro Planning Commission  
Flint, MI  
(810) 257-3010  
FAX (810) 257-3185
  7. CEO Council, Inc.  
S.W. MI TAC  
Kalamazoo, MI  
(616) 342-0000  
FAX (616) 343-1151
  8. Jackson Alliance for Small Business Development  
Jackson, MI  
(517) 788-4680  
FAX (517) 788-4337
  9. Downriver Community Conference  
Southgate, MI  
(313) 281-0700  
FAX (313) 281-3418
  10. Warren/Center Line/Sterling Heights Chamber of Commerce  
Warren, MI  
(810) 751-3939  
FAX (810) 751-3995
  11. Schoolcraft College Business Development Center  
Livonia, MI  
(313) 462-4438  
FAX (313) 462-4439
  12. Wayne State University (City of Detroit)  
Detroit, MI  
(313) 577-4850  
FAX (313) 577-8933

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The Michigan International Business Development Center (MI-IBDC) at Michigan State University functions as the international trade specialty center in the statewide Michigan Small Business Development Center network. All counseling is conducted by international professionals. A variety of training programs ranging from short presentations to major conferences are conducted. The MI-IBDC functions as a unit of the Eli Broad

College of Business and the Eli Broad Graduate School of Management at Michigan State University. Its address is 7 Eppley Center, Michigan State University, East Lansing, MI 48824. Phone is 517-353-4336.

Some utility companies also provide programs and information on the global economy. Many Small Business Development Centers also have exporting market information.

# Advertising and Promotion



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The purpose of advertising and promotion is to let your customers know about your product or service. It is especially important when you open your business. It may be one of your largest budget expenses in the beginning, so plan carefully.

Once you have identified your target customers and completed your market research, your advertising and promotion will be easier. After you have a description of your product or service, including special features, and your target market, you need to determine where your target customer looks for information on products and services to buy.

You must weigh the costs and benefits of any promotion strategy. No one can use all these ideas. Select your basic business type and look for choices that are better for your type of business (see chart on next page):<sup>1</sup>

- Service business for consumers.
- Service business for businesses.
- Service/product business for consumers.
- Service/product business for businesses.
- Product business for consumers.
- Product business for businesses.

The elements of a successful promotion campaign include:

- Your personality.
- Your budget.
- Your business type.
- Your time.

As a general rule, things that cost the least money take the most time.

<sup>1</sup> Edwards, Paul; Sarah Edwards and Laura Clampitt Douglass. *Getting Business to Come to You*. Los Angeles: Jeremy P. Tarcher, Inc., 1991.

## Direct marketing

1. *Demonstrations* — Can you informally show your product or service to customers? Festival days or mall shows are good times for demonstrations. If you are working with business customers, you can set up a demonstration session. Anytime you can do an actual demonstration of how you to use your product or service, you will find interested people.

2. *Shows* — Trade and consumer shows are organized around a multitude of themes — e.g., antique shows, business equipment, craft shows, boat shows, camper shows, coin or stamp shows. Is there a show that relates to your product or service? Get a list of shows from tourist bureaus or chamber of commerce offices in the cities or towns where you are selling your product or service. If there is a civic center or exhibition center, write for its list of shows and names and addresses of show organizers.

3. *Open houses* — Open houses are increasing in popularity for gift products, especially around the holiday season. If your home does not make a good setting, perhaps you can rent a location with a group of people who have similar products.

4. *Portfolio* — Put together a collection of your best work. This may be photographs of your products or pictures of the results of your service. You may want to include a resume and list the advantages or special features of your business. If you provide a service, include letters from satisfied customers and be able to suggest past customers as references.

# Home-based Business – Advertising and Promotion

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## Measure-of-success Probability Chart

### Key to symbols

- \* Greatest probability
- ✓ Good probability
- Medium probability
- ✗ Less probability
- Not applicable

	Service to consumers	Service to business	Service/product to consumers	Service/product to business	Product to consumers	Product to businesses
<i>Direct marketing</i>						
Demonstrations	■	■	○	*	✓	*
Shows, fairs, festivals	○	✓	*	*	*	*
Open house	✗	✗	○	○	*	*
Portfolio	*	*	*	*	○	○
Newsletter	○	✓	✗	✓	✗	○
Incentives, coupons	*	✓	*	✓	*	✓
Circulars, flyers, brochures	*	✓	*	○	✓	○
Contests	✓	○	○	○	*	○
Direct mail	✓	✓	*	○	*	○
Samples	✗	✗	○	○	*	*
<i>Word of mouth</i>						
Networking	○	*	○	*	✗	*
Gatekeepers	*	*	*	*	*	*
Volunteerism	○	*	○	✗	✗	✗
Charitable donations	✓	*	✓	*	✓	*
Business card	✗	*	✗	*	✗	*
Letterhead stationery	✗	*	✗	*	✗	*
Product packages, hang tags	■	■	✓	○	*	✗
Rolodex cards	✗	*	✗	*	✗	*
Specialty items	*	*	*	*	○	○
<i>Advertising</i>						
Classified ads	✓	✗	✓	○	*	✗
Display ads	○	✗	○	○	*	○
Yellow pages	*	✓	*	✓	✓	○
Directories	✗	✓	✗	*	✗	*
Bulletin boards	*	✗	*	✗	✓	✗
<i>Publicity</i>						
Free newspaper	*	✓	*	✓	✓	✓
Free radio, TV	*	○	*	○	✓	✗
Speeches, seminars	✓	*	○	✓	✗	*
Writing articles	○	*	✓	*	✓	✓

Adapted from:  
Edwards, Paul; Sarah  
Edwards and Laura  
Clampitt Douglass.  
*Getting Business to  
Come to You.*  
Los Angeles: Jeremy  
P. Tarcher, Inc., 1991

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5. *Newsletter* — A newsletter puts you and your product or service in the customer's mind on a regular basis. New ideas for using your product or service will give you repeat sales.

6. *Incentives (coupons)* — Make up a small coupon for distribution through other businesses or in a local newspaper or shopper. Coupons are good if you have a special price or are offering a discount. You can track coupons by coding them. For instance, if you are putting them in different locations, color code them. If you are putting them in newspapers, insert a different code — Dept. A, B, etc. — in the coupon for each paper.

7. *Circulars, flyers or brochures* — If pictures give you a better message, consider the printed page. Some small-business people use both a business card and a brochure. Others use a brochure in place of a business card. Pictures add to the appeal of your brochure. Be sure you include your address and phone number. If appropriate, add an order form to make it easy for customers to buy from you. If you show products or services with prices, consider an insert that lists prices — this keeps brochures current when prices change so you don't have to throw away old ones and reprint.

8. *Contests* — People like to win a product or free service. Have a drawing to win a free product or service.

9. *Direct mail* — Direct mail can be your main method for reaching your customers or it can supplement other approaches. You can

purchase lists of addresses from companies that specialize in direct mail information, but the best list is the one you create yourself. Consider getting names and addresses in the following ways:

- Have customers sign a book for mailings on sales or special events.
- Copy names and addresses from any checks you accept.
- Write customer names and addresses on sales slips.
- Have a drawing for a prize and ask entrants to write their names, addresses and phone numbers on the entry form.
- Collect business cards from exhibitors at shows, at the meetings you attend and from all personal contacts.
- Use a classified ad that offers information on your product or service. People who respond to this ad and any form of advertising should be added to your mailing list.

10. *Free sample* — Everyone loves a free sample. Food products lend themselves well to samples, but samples of products such as cosmetics, soap products or yarn can also be effective. If possible, attach your business name and address so that people will remember where they got the sample. Service businesses can offer a free half-hour of consulting. One financial planner gives 30 minutes of help in return for 30 of anything: pencils, paper clips, cookies — whatever the person brings in. The 30 items are then donated to a local charity.





## Word of mouth

Most small-business people agree that word of mouth is the best advertising. If your satisfied customers give your name to someone else, you build your reputation and your customer base.

1. *Networking* — Use your ties to community groups such as service clubs to network with potential customers and to sell your products or services. You might also consider becoming a speaker for these organizations if you have an interesting story to tell.

Networking can be done at local business meetings, community organizations, or church or social gatherings. Or you may attend a state, regional or national meeting. Some tips for networking from Paul and Sarah Edwards<sup>2</sup> include:

- Join one or two key civic, professional or trade organizations that have members that you can do business with or businesses compatible to yours.
- Attend meetings regularly.
- Become an active member by serving on committees and assuming leadership roles.
- Make a point of meeting new people at each function the organization conducts.
- Schedule one or two business meals from the contacts you have made at the meetings — the ones that seem most promising.
- Actively refer business to those you meet. Keep the networking going.

2. *Gatekeepers* — A gatekeeper is an influential person to whom others turn for advice. Who would be the gatekeepers for your target customer? For example, if your business is a lawn service, you need to introduce yourself and your business to operators of local landscape and nursery businesses.

3. *Volunteerism* — Is there a local charity or service organization that could use your professional advice or expertise? Both service and product business persons have skills that are in demand. Volunteer activities often lead to business activities.

4. *Charitable donations* — Does your product or service fit with requests you get from organizations for donations? Don't forget that you are trying to reach your target customer. Rather than donating money to certain organizations, consider donating your product or service.

5. *Business card* — Your business card is the first advertising expenditure you should consider. Give the card to all potential customers. It establishes you as a serious business person and gives customers a quick, easy way to find your address and phone number.

6. *Letterhead stationery* — If you are considering special type or a logo for your business card, it makes good sense to coordinate this with letterhead stationery. As you start to correspond with customers or suppliers, it will give your business a professional image.

<sup>2</sup> *Getting Business to Come to You*, pp. 26-29.

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7. *Product packaging* — Hang tags, bags or packing boxes keep you identified with your product. Be sure to include your name, address and phone number. A hang tag can add information about your product and help educate the customer on the benefits as well as provide any necessary information on use and care. If your product is likely to be a gift item, design your tags so that the price can be put in a corner. This way the price can be clipped off but your name and address will stay with the gift. If you package your product in a box or bag, work with a graphic artist or print shop to develop a design that matches your business card and letterhead stationery.

8. *Rolodex cards* — If business customers are your target, designing your business card as a Rolodex card for their phone files can be an effective tool. Local printers have Rolodex card stock or can incorporate a punchout Rolodex card in a brochure.

9. *Specialty items* — Will your customer use an item such as a calendar with your name and address? Though it's more expensive than a business card, a specialty item may keep your name in front of your customer longer.

## Advertising

1. *Classified ads* — Small-town newspapers, local shoppers and classifieds in targeted magazines are often good advertising methods for a small business. Classifieds are most effective if you can describe your product well, have a service business or use the ad to generate a request for more information.

2. *Display ads* — Newspaper and magazines ads can reach a large group of customers if they're placed in the right publications. A display ad is paid space in the news sections of the publication. Prices will vary greatly, depending on the circulation of the publication and the location and size of the ad. If you find an interesting publication, check near the table of contents or the title page for the address to write for more information. Publications will send you a rate sheet with specific costs and deadlines for submitting material.

3. *Yellow pages* — If you have a business phone and determine that customers will find you easier in the yellow pages, check into the cost. You will automatically receive a one-line listing as a business phone customer. More space will involve an additional charge. Today many companies publish and distribute phone books. Be sure you know where and to whom the book will be distributed before you buy space.

4. *Directories* — Community, church or trade directories are a few possibilities. Trade directories are very valuable if you are trying to reach business customers. Most directories charge for space. They are then distributed to customers at no charge.

5. *Bulletin boards* — Attractive flyers on a bulletin board seen by your target customer can be an easy and effective way to reach people. Don't put your ads on bulletin boards that are devoted to garage sales and personal ads or you will get lost in the crowd.



## Publicity

1. *Free newspaper, radio or TV* — Radio and television advertising may be too expensive to consider for a starting business, but many small papers and radio or TV stations are interested in local news. Cable TV stations may have a channel for local business news. A radio station may have a local talk show or a newspaper may feature an interesting new business in the community. This is invaluable publicity. Contact the editor or program director and be prepared to present an interesting description of your business.

2. *Speeches/seminars* — Can you teach a class on your product or service that will put you in contact with potential customers? Informal community education organizations are always looking for topics and speakers.

3. *Writing articles* — Do you have the skills to write an article for a trade magazine or a magazine targeted to your customers? Very often people who read articles contact the author for more information. This can start a networking chain.

## Evaluating advertising and direct marketing

Once you have planned and implemented an advertising and promotion approach, you need to evaluate its success. Each method will cost dollars and time, so you will need to track the sales results from each effort.

For example, to weigh the immediate response to a specific advertising approach, you can track:

- The number of coupons brought in. Usually these coupons represent a product sale. By dating and coding your coupons, you can track both the source and the number of returns by time period, location, advertising medium, etc. For example, if you decide to run the coupon in two different newspapers, print an “A” in the coupon for one paper and a “B” in the coupon for the other paper. Count the responses to each ad to determine which ad was more effective.
- Requests by phone or letter referring to a display ad.
- Actual sales from a classified ad or display ad.

Use the form developed by Barbara Brabec in her book, *Homemade Money*, as a starting point in your evaluation.

The form (page 101) suggests a classified ad, a display ad, direct mail and publicity. You may choose to use other approaches such as coupons, posters or shows. The key is to track the results. An easy way is to ask your customers where they saw your ad or heard about your business. If your conversation occurs in person or on the phone, ask the question as part of taking an order or giving information. Mail response is easy to track because you can identify the source from a brochure, coupon or ad in a newspaper or magazine.

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Once you have a system in place, you can start to evaluate. Barbara Brabec gives the following example of both a display ad and a classified ad placed in the same magazine:

“For example, if a classified ad costs \$60 and generates 75 inquiries, your per-inquiry cost would be 80 cents.

“If you were to place a display ad in the same publication — one that cost \$250 and brought in 197 inquiries — your per-inquiry cost would be \$1.27. In this instance, then, classified ads would certainly be the most cost-effective way to generate inquiries in this particular magazine.”<sup>3</sup>

Thus you evaluate on a common factor, cost per inquiry, rather than just on the total cost of the ad or other advertising method. Another method is to track the dollar sales resulting from each ad. Comparing dollar return with ad costs will reveal where your advertising cost per dollar in sales is lower.

As your history of responses builds, you will find out which advertising method or medium or location pulls the best for you. You may decide to concentrate on the alternatives that produce the best results.

Your advertising and promotion efforts take time and dollars. You are trying to accomplish two major goals:

1. Create a positive image as an established business person in your community. This image is important in building trust and reliability. You want customers to know that yours is a business they can count on. Creating a good image will not show directly in sales figures but will have a long-term effect on your business.
2. Stimulate sales. You need to communicate with your customers. You use advertising and promotion to communicate. The better the communication, the better your sales results. An ad or promotion for a specific product or service is designed to sell that item. The time to run advertising that stimulates sales is during the peak season for your product or service. If your product or service is not seasonal — e.g., snow removal or lawn care — you can determine your best sales periods by keeping track of your monthly sales.

<sup>3</sup> Brabec, Barbara. 1987. *Homemade Money*. Whitehall, Va.: Betterway Publications, Inc.





## Advertising worksheet

This is your opportunity to start developing five specific pieces: logo, business card, classified ad, yellow pages ad and display ad. Start by finding examples that appeal to you. Analyze the examples and determine what to include as you think through the items for your business.

Shop for estimates on the initial costs for your advertising pieces and be sure to include this in your estimate of start-up costs. Working with a graphic artist may be more expensive than using your own graphics or clip art. You will need to weigh cost against quality and effectiveness.

---

### Logo

Your logo is a graphic design that identifies your business. Enlist the aid of a graphic artist to help create a symbol or logo to represent your business, or experiment on your own. Examine other business logos. Strive for a logo that's distinctive, easy to read, uncluttered and

professional-looking. Use it consistently on your business cards, stationery, bills, signs, bags or boxes, or anything that your customer will see. Have copies made in different sizes so that it can be reproduced in ads or other printed materials. Have it made into a rubber stamp.



---

## *Business card*

Study several business cards that you find appealing. What items stand out? the logo? the information? Start developing a sample business card for your business. Include the busi-

ness name and address; your name and telephone number; your fax number, 800 number or Internet address, if you have them; product and special services; logo and motto, if you have one.

---

## *Classified ad*

Look in your local newspaper for classified ads. What types of products or services are most commonly advertised? Does your business product or service fit in? If so, start developing

a classified ad. Be brief and creative. Get the customer's attention. Your ad should be easy to read, informative, uncluttered and professional-looking.



---

## *Yellow pages ad*

Leaf through your yellow pages directory and find ads that attract your attention. Use these ads to start developing an ad for your business. Include the same information that appears on

your business card. You may want to include your business hours or the geographic area you serve.

---

## *Display ad*

Remember that the purpose of a display ad is to inform your customers and persuade them to buy your product or service. This type of advertising is more expensive, so you need to spend more time thinking about this type of

ad. Be creative! Entice but be honest. Use action words – such as “learn”, “discover”, “deliver” and “solve” – in the text. Look through newspapers and magazines that your customer reads.



# Home-based Business – Advertising and Promotion

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## 1. Create an identity.

Ads with your logo or other distinctive artwork and copy enjoy a higher readership, several studies have shown. If you want the reader to single you out on the page, don't look like the competition.

## 2. Use a simple layout.

Be clever but never cryptic. The reader's eye should move in a simple, logical sequence from headline to illustration to explanatory copy to price to your name and logo. An eye-dazzling ad might get initial attention, but too many type faces and decorative borders can turn attraction to distraction.

## 3. Have a definite focus.

Newspapers and magazines are a visual medium. The consumer's eye is quickly drawn to a well chosen photograph or interesting artwork that will lead him/her to read about what you're selling.

## 4. Feature consumer benefits.

Your customer wants to know "What's in it for me?" before seriously considering a purchase. If price is your selling feature, make that your banner statement. In general, headlines should appeal to your customer's needs while playing up your strong points.

## 5. Avoid congestion.

Don't overcrowd your ad. The average news page is filled with print. A display ad is your opportunity as an advertiser to open up some of that area with white space that gives your copy room to breathe. White space is a good

eye-catcher that allows copy within the ad to stand out. In ads featuring a large number of items, as in a sale, it takes extra effort to tell the whole story in the most readable way.

## 6. Tell the whole story.

Tell all of the most appealing points about the product or service, such as color, size, fashionability, or skills and results. Be enthusiastic to get across the message that you stand behind your words 100 percent. A boldface lead-in and accompanying illustrations are strong aids to readership.

## 7. Name your price.

Readers will often overestimate omitted prices, so don't hesitate to list them. If the price is comparatively high, then justify the price by highlighting the item's outstanding features, before- and after-the-sale service, etc.

## 8. Include related items.

Make two sales instead of one by offering other items along with a featured one.

## 9. Urge your readers to buy now.

Ask for the sale. You can stimulate prompt action by using such phrases as "limited supply" or "this week only." If you include mail-order coupons in your ads, provide spaces large enough for customers to write in easily.

## 10. Always include your name and address.

Check every ad to be certain you have included your business name, address and telephone number. In business ads, add your fax number.



## 11. Avoid being too clever.

Many people distrust cleverness in advertising just as they distrust salespeople who are too glib. Headlines and copy generally are far more effective when they are straightforward than when they are tricky. Clever or tricky headlines and copy often are misunderstood.

## 12. Use simple, everyday words.

Many of your customers may not understand words that are familiar to you. Everybody understands simple language. Nobody resents it. Use it.

## 13. Avoid making excessive claims.

The surest way to lose customers is to make claims in your advertising that you can't back up. Go easy with superlatives and unbelievable prices. Remember: if you claim your prices are unbelievable, your readers are likely to agree.

## Using direct mail

Direct mail advertising has many possibilities for the home-based business. Though postage is expensive, communicating directly with your customers may give better results than scattering your advertising dollars across a wider audience. You can use direct mail for the following:

1. To solicit mail-order business.
2. To announce new items, changes in products or services.
3. To welcome new customers.

## 4. To help regain lost customers.

## 5. To thank customers for their business.

## 6. To announce sales or special prices on your product or service.

## 7. To announce a special showing of your product in their area.

## 8. To remind customers of seasonal or periodic needs. This is especially important if you have a product or service that customers can use more than once.

## *The mailing piece*

What you mail will depend on your budget and your needs. It can be as simple as a postcard or as elaborate as a full color printed brochure or newsletter. Postcards are easy to do and cost the least to mail. You might want to consider a hand-lettered approach if you are an artisan or a computer-generated postcard if you are in a secretarial business. The style should reflect your business.

Self-mailers are easy to do if you use heavy enough paper and fold your brochure. You might even consider including an easy-to-fill-out order form. Be sure to make the spaces large enough for customers to fill out easily. If you want to use a postage-guaranteed reply card, contact the post office for the cost of the postage plus the service and handling charge.

## *Bulk mail*

If you often have 200 or more identical pieces to mail, check with your local post office for a bulk mail permit. This will reduce your mail-



ing costs. If you are doing large mailings, the postal service would like you to use a new style in addressing your mail. If you are planning to computerize your customer list, keep this in mind before starting:

1. Address should be in ALL CAPS.
2. Keep the address together. Do not put notations at the lower left-hand corner of the envelope.
3. The state name should be the standard two-letter abbreviation, e.g., MI.
4. Abbreviate where you can and avoid punctuation. AVE and ST are preferable to Avenue or Street.
5. Use the ZIP+, if possible.
6. Always include your return address in the upper left-hand corner of the envelope.

The preferred format is:

JANE JONES  
PO BOX 20137  
EAST LANSING MI 48824-1095

## *Your mailing list*

Your mailing list is the most important part of a direct mail effort. If you wish to reach out to new customers, here are some suggestions:

1. Use a reverse telephone directory, which lists names by streets. If you want to cover a certain geographic area, you can blanket that area with a mailing.
2. If you wish to reach other businesses, check professional, trade or industrial directories.
3. Check the newspaper announcements of births, engagements, marriages or wedding anniversaries if your product or service is related to these events.
4. Service clubs, professional groups, churches or fraternal orders may rent the names of their members as a way to raise money.
5. Check with businesses that are not direct competitors. Perhaps you can exchange lists or rent their lists.
6. Many companies are in the business of compiling lists. They have specialized lists for a wide variety of target markets.

# Pricing



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# Home-based Business – Pricing

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Determining prices for the products or services your business sells is one of the most challenging tasks facing the new entrepreneur. Too often, home business owners do not carefully consider how to set a price for their product or service before opening shop. Many tend to charge less than they could, rather than more, not realizing that the best price for a product or service is not necessarily the price that will create the most business. Rather, the “best” price is one that will maximize the profits of the company.

When you worked on marketing, you described your target customers. As a result, you should know whether they will be wholesale, retail or custom product/service buyers. You also assessed the competitors in your trade area—the geographic area from which you expect to draw most of your customers. Now you know if the customer you are trying to attract is willing to buy at low, medium or high prices.

When setting a price, there are other considerations to keep in mind. What is the highest price customers are willing to pay for your product or service? Sometimes high prices are associated with prestige and quality — you may be considered more “professional” if you charge high prices. If your product or service does not meet these expectations, however, you will lose customers.

A new and unique product or service will allow you to set higher prices. But if you are offering products or services similar to those of your competitors, you need to price competitively.

If you are just entering a market with several competitors, low prices are a way to attract customers. Though it is also a way to generate a high sales volume, be aware that volume doesn’t always compensate for prices too low to make a profit.

Regardless of demand, cost is an overriding factor. You must determine what the product or service costs, what your labor is worth and what percentage of profit you must receive. The basic cost approach to use in pricing is:

$$\text{Expenses (materials and overhead) + labor} \\ + \text{profit} = \text{price}$$

## Terms

### Markup

*Definition:* The amount by which the direct cost of goods and services is increased to generate a retail selling price.

*Formula:* Direct cost x markup percentage = retail selling price

### Margin

*Definition:* The financial amount or the percentage of the selling price not represented by the direct cost of the item sold.

*Formula:* Selling price - direct cost = margin

### Markdown

*Definition:* The amount by which the established price of goods or services is reduced to stimulate increased unit sales.

*Formula:* Established price - markdown amount or % = selling price

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## Discount price

*Definition:* The price to which the seller reduces an established price to encourage the buyer to pay more quickly or buy in larger volume or to produce other similar benefits.

*Formula:* Agreed price - discounted amount or % = discount price

## Price bid

*Definition:* The amount for which a service or contracting company agrees to perform work, usually of a custom nature.

*Formula:* Cost per hour + cost of materials x markup percentage = price bid

## Pricing for service providers

The total cost of producing any service is composed of three elements:

- The material cost.
- The labor cost.
- The overhead cost.

Material cost + labor cost + overhead = total cost of service

### Material cost

Material cost is perhaps the easiest to compute. The material cost is made up of the cost to you for parts and supplies used on a specific job. Once you know which parts and/or supplies will be needed for a job, make a list of the needed items and the quantities that will be used. If the needed materials are in

stock, check your invoices to determine their cost to you. If you have to order parts or supplies, check with the supplier to get an up-to-date price. Shipping, handling and storage costs should be included in the material cost.

### Labor costs

Labor costs are determined by multiplying the number of hours required to do a job by the cost per hour. It is very important to determine accurately how many hours will be needed to complete a service, so use a time clock, a worksheet or a daily time card to determine the exact amount of time spent on each job.

The hourly cost of labor can be figured two ways. One is hourly wage only, with all fringe benefits such as Social Security or paid vacation allocated to overhead. Or the hourly cost of labor can include hourly wages plus the employer's contribution to Social Security, holidays and vacations, and other fringe benefits. With the second method, the costs of Social Security, unemployment compensation and fringe benefits are expressed as percentages of hourly wages. In most home-based businesses the proprietor is the only employee, so it may be easier to determine the hourly wage using the second method. Calculating your hourly cost gives you a more realistic view of what you can earn from this business.

### Overhead costs

Overhead includes all job-related costs other than materials and labor. Overhead is the indirect cost of the service and is made up of materials too minor to include in materials

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cost (such as machine lubricant or incidental supplies); and of other indirect costs such as taxes and insurance. Use the federal tax form Schedule C to determine the possible overhead categories.

In determining the total overhead cost, you should not depend on last year's income statement. The best approach is to project anticipated overhead expenses for the next six months to one year.

Determining overhead costs is perhaps one of the most difficult aspects of pricing for the home-based service producer. To determine overhead, a person working in the home should at least place a value on the space used and approximate the portion of the indirect costs that might be attributed to the business. One way might be to use the percentage allocation allowed by the IRS for a home office deduction. Determine the area of your home used for your business. Calculate the total square footage of your home — including the portion that you've set aside for business use. To get the total square footage of your home, determine the square footage of each room by multiplying the number of feet of a room's width by its length. Add all the rooms' square footage to arrive at your home's total square footage. Then divide the square footage of your business area by the total square footage to get the percentage allocated to your business.

For example, if you own a house with 2,000 square feet of space and use 120 square feet for your business, you would get your business space percentage by dividing 120 by 2,000 ( $120 / 2,000 = .06$ ). Six percent of your home is

used by your business, so 6 percent of the indirect expenses can be attributed to your business. For an accurate calculation, use income tax form 8829, "Expenses for Business Use of Your Home." This form walks you through every calculation related to the business use of your home and keeps you from making mistakes. (Use the worksheet below to help you calculate indirect business expenses.) Direct expenses such as attorney or accounting fees, advertising, travel costs, dues and subscriptions, equipment costs, supplies, taxes, repairs, etc., are more easily accounted for in the overhead calculation.

## XXX Service Company

Projected Overhead Expenses  
for the Year 19 \_\_\_\_\*

### Indirect materials:

- Office expenses (including stationery and supplies, bags, other wrapping materials, price stickers or tickets, business forms). \$ \_\_\_\_\_
- Stamps and postage. \$ \_\_\_\_\_
- Maintenance (includes repairs, cleaning, repainting of store, shop or office, and equipment). \$ \_\_\_\_\_
- Supplies. \$ \_\_\_\_\_
- Utilities (heat, electricity, water). \$ \_\_\_\_\_
- Communications (includes long-distance telephone if you do not have a business line, telegrams, overnight delivery services). \$ \_\_\_\_\_



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## Other indirect costs:

- Professional services (such as lawyers, accountants, credit bureaus). \$ \_\_\_\_\_
- Advertising. \$ \_\_\_\_\_
- Auto/truck expenses. \$ \_\_\_\_\_
- Depreciation (equipment and vehicles). \$ \_\_\_\_\_
- Insurance (on the building, if owned; on the equipment and merchandise). \$ \_\_\_\_\_
- Interest (on money borrowed to start or expand the business; for unexpected expenses). \$ \_\_\_\_\_
- Licenses. \$ \_\_\_\_\_
- Rent or mortgage payments. \$ \_\_\_\_\_
- Bad accounts and collection (the business either has to absorb the cost of a bad check or unpaid account, or pay a lawyer or collection agency to obtain payment). \$ \_\_\_\_\_
- Theft, spoilage, breakage (take into account losses due to these factors). \$ \_\_\_\_\_
- Donations (to community projects or charities). \$ \_\_\_\_\_
- Discounts (if given). \$ \_\_\_\_\_

\*To ensure that all overhead costs are included, it is best to project overhead costs for a full year. This will help when figuring expenses that occur only once or twice each year, such as business licenses and insurance.

To determine the overhead cost allocated to a specific job, multiply total labor cost by the overhead rate. An overhead rate is established by dividing total overhead costs by total labor costs. For most small businesses, the overhead rate is between 100 percent and 200 percent of the total labor cost (expressed as 1.00 or 2.00). After you have been in business for a while, you will be able to determine which rate applies to you. Here is an example of figuring the overhead cost per job:

Labor cost this job x overhead rate =  
overhead cost                       $\$8.80 \times 2.00 = \$17.60$

Now, to determine the total cost of the service job, add material costs, labor costs and overhead costs

Material costs + labor costs + overhead cost =  
total cost of job  
 $\$20.00 + \$8.80 + \$17.60 = \$46.40$

## Profit

Once you have determined the total cost for a job, you need to calculate the profit and add it to the total cost of the job to get the price to charge for the service.

Total cost of job + profit = price

Profit and wages are not the same thing, though most home-based workers tend to forget this fact. After you have paid all the expenses related to your business (including your own salary), the idea is that there still should be something left over as profit for the owner or company. But there won't be if you forget to include profit in your pricing formula.

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Profit is influenced by the prices charged by your competitors, inflation, the amount of business you have, the efficiency and quality of your service, and other consumer pressures.

The common business practice is to express profit as a percentage of the base used for pricing. For example, once you have determined the total cost of a job, try adding a 10 to 20 percent profit margin. These examples show how the profit calculation affects the total price:

10% profit:  $\$46.40$  total cost of job  $\times$  10% =  
 $\$4.64 + \$46.40 = \$51.04$  price of service

20% profit:  $\$46.40$  total cost of job  $\times$  20% =  
 $\$9.28 + \$46.40 = \$55.68$  price of service

Though this small hike in the price may mean little or nothing to the buyer, it can mean a whole lot to you. For example, if you have 50 jobs, look what happens:

10% profit:  $\$4.64 \times 50$  jobs =  
 $\$232$  profit for you

20% profit:  $\$9.28 \times 50$  jobs =  
 $\$464$  profit for you

## Other factors

Other factors will also affect your pricing strategy. Some of these are more applicable to a custom product/service business, but all these factors are important in your pricing decisions.

**Volume:** You may be able to offer lower prices if you anticipate a greater sales volume or large number of service jobs. Sometimes, however, the expense of doing more jobs (extra vehicles, an employee) outweighs the projected profit.

**Value:** Seasonal or fad services bear higher prices because of their perceived desirability by customers. If you have ever purchased a fad service (nail sculpturing, for example) what do you think the cost to the service provider was? How much was the profit margin? This practice — inflating the profit margin to take advantage of fads or trends — is called “skimming the market.” The opposite of skimming the market is called “penetration pricing,” setting one’s prices abnormally low to become established in a market. Price is often the indicator by which customers judge quality.

Customers have a reference price in their mind. It can be what they consider fair, what they expect to pay based on past experience or what other service providers are charging.

**Supply and demand:** Customers are willing to pay more for services that are limited in availability and less for services that are easily available. If you are the only service provider in your geographic area, you may be able to charge more.

**Image:** A restaurant that features a “gourmet dining experience” could charge more than a family-style buffet operation. Sometimes people think that anything that is expensive must be good. When there is little difference in prices, customers are influenced by image.

# Home-based Business – Pricing

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**Profit goal:** You should make enough of a profit to cover the risk of doing business and make a return on the money and equipment you have invested in the business.

**Inflation and increased overhead:** The cost of doing business rises periodically and predictably. The amount charged by your suppliers will be out of your control. Because customers resent frequent price changes, you need to set prices that cover these changes. Estimating the cost of replacing inventory/materials in the future must be part of every pricing decision. When costs suddenly rise, what will be the effect on volume of sales and customer loyalty of “passing through” higher costs to the consumer? Would it be better policy in the long run to give up some or all the profits on a service by absorbing the higher costs while keeping prices stable? Can you afford to do this?

**Location:** Where you sell affects the prices you can charge. If you are offering a service in urban, suburban and high-income areas, you will usually get higher prices. Prices in rural and economically poor areas are generally lower.

**Discounts/specials:** Occasionally you may have to offer specials or discounts to increase business. Have you set prices high enough so you do not incur a loss when you discount services?

**Estimates:** In many service businesses, an estimate of the final price for the work to be

done can be offered to the customer. The business person may guarantee that the service will cost no more than the estimate, or that the estimate is correct within a certain percentage. Whatever your policy for giving estimates, stick to it. This will preserve your business reputation and integrity. You may also want to charge for figuring an estimate if it is time consuming.

**Competition:** Comparison shop before you set a price. Find out what your competition is charging. Instead of undercutting your competitors, offer a somewhat different service. If your service has more to offer, such as free delivery, faster service or better quality, it may be worth more to your customers than what the competition offers. The bottom line is competition. You have only three pricing strategies compared with your competition: higher, lower or the same. If you are either higher or lower, you need to explain why.

The total cost of producing a service is composed of material, labor and overhead costs. This cost information is used as the basis for setting prices and profit. From alternative pricing methods, you select one that results in a satisfactory profit and is easy for you to use. Given competition and the economy, you must have a pricing strategy that keeps your service competitive and profitable. The more exactly you figure your costs and set prices, the greater your chances for a continued profitable business.



## Pricing for product makers

The total cost of producing any product is composed of three elements:

- The material cost.
- The labor cost.
- The overhead cost.

Material cost + labor cost + overhead = total cost of product

### Labor

Labor costs are determined by multiplying the number of hours required to do a job by the cost per hour. It is very important to determine accurately how many hours will be needed to complete a service, so use a time clock, a worksheet or a daily time card to determine the exact amount of time spent on each job.

The hourly cost of labor can be figured two ways. One is hourly wage only, with all fringe benefits such as Social Security or paid vacation allocated to overhead. Or the hourly cost of labor can include hourly wages plus the employer's contribution to Social Security, holidays and vacations, and other fringe benefits. With the second method, the costs of Social Security, unemployment compensation and fringe benefits are expressed as percentages of hourly wages. In most home-based businesses the proprietor is the only employee, so it may be easier to determine the hourly wage using the second method. Calculating your hourly cost gives you a more realistic view of what you can earn from this business.

### Materials

Next to labor, the cost of materials is the most important consideration in setting a price on any product. Small product makers who create a limited number of items for sale each year often run into trouble obtaining wholesale prices for materials. Finding reliable and affordable suppliers is a major challenge for all business owners, regardless of size or type. It may take a couple of years before you finally have solved most of your supplier problems. One way to find the special supplies you need is to obtain copies of the Thomas Register of Manufacturers or yellow pages from large cities from your library. Once you know from whom you want to order, be prepared to meet their minimum quantity requirements. Another way to find the special suppliers you need is to network with others in your industry, through membership in professional organizations and subscriptions to newsletters and trade periodicals.

### Overhead

Determining overhead costs is perhaps one of the most difficult aspects of pricing for the home-based product maker. To determine overhead, a person working in the home should at least place a value on the space used and approximate the portion of the indirect costs that might be attributed to the business. One way might be to use the percentage allocation allowed by the IRS for a home office deduction. Determine the total area of your home (including the portion that you've set aside for business use). To get the total square footage of your home, determine the square

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footage of each room by multiplying the number of feet of a room's width by its length. Add all the rooms' square footage to arrive at your home's total square footage. Then divide the square footage of your business area by the total square footage to get the percentage allocated to your business.

For example, if you own a house with 2,000 square feet of space and use 120 square feet for your business, you would get your business space percentage by dividing 120 by 2,000 ( $120/2,000 = .06$ ). Six percent of your home is used by your business, so 6 percent of the indirect expenses can be attributed to your business. For an accurate calculation, use income tax form 8829, "Expenses for Business Use of Your Home." This form walks you through every calculation related to the business use of your home and keeps you from making mistakes. Direct overhead expenses, such as equipment costs, supplies, taxes, repairs, advertising, professional help and interest charges, are more easily accounted for in the overhead calculation.

## ZZZZ Product Makers

Projected overhead expenses  
for the year 19\_\_\*

### Indirect materials

- Office expenses (includes stationery and supplies, bags, other wrapping materials, price stickers or tickets, business forms). \$\_\_\_\_\_
- Stamps and postage. \$\_\_\_\_\_

- Maintenance (includes repairs, cleaning, repainting of store, shop or office, and of equipment). \$\_\_\_\_\_
- Supplies. \$\_\_\_\_\_
- Utilities (heat, electricity, water). \$\_\_\_\_\_
- Communications (includes long-distance telephone charges if you do not have a business line, telegrams, overnight delivery services). \$\_\_\_\_\_

### Other indirect costs

- Professional services (such as lawyers, accountants, credit bureaus). \$\_\_\_\_\_
- Advertising. \$\_\_\_\_\_
- Auto/van expenses. \$\_\_\_\_\_
- Travel (for product makers, the expenses of traveling to and from market outlets). \$\_\_\_\_\_
- Depreciation (equipment and vehicles). \$\_\_\_\_\_
- Insurance (on the building, if owned; on the equipment and merchandise). \$\_\_\_\_\_
- Interest (on money borrowed to start or expand the business; for unexpected expenses). \$\_\_\_\_\_
- Licenses. \$\_\_\_\_\_
- Rent or mortgage payments. \$\_\_\_\_\_
- Taxes (on business location, if owned). \$\_\_\_\_\_

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- Bad accounts and collection (the business either has to absorb the cost of a bad check or unpaid account, or pay a lawyer or collection agency to obtain payment). \$ \_\_\_\_\_
- Theft, spoilage, breakage (take into account losses due to these factors). \$ \_\_\_\_\_
- Donations (to community projects or charities). \$ \_\_\_\_\_
- Discounts (if given.) \$ \_\_\_\_\_

\*To ensure that all overhead costs are included, it is best to project overhead costs for a full year. This will help when figuring expenses that occur only once or twice a year, such as business licenses and insurance.

## Profit

After considering labor, materials and overhead, you should decide how much you wish to include for profit. Usually it is 20 to 30 percent of the selling price.

## Examples of various pricing methods

You are marketing wooden salad bowls. To understand the difference between including all factors in your price and other pricing methods, below are three examples.

The critical factor is what the consumer will pay for the product you produce. Keep in mind that retail prices reflect at least a 100 per-

cent markup (wholesale price per unit x 2 = retail selling price per unit). The product maker receives about half that amount.

If your wholesale price is too high to be competitive, you need to improve your production process or reduce your overhead. If you, the maker, cannot realize a profit in addition to your wages, perhaps you should drop the product.

You spend approximately 2 hours making one bowl. You can produce 20 wooden salad bowls in a 40-hour week. You want to earn \$7.50 an hour (\$300 per week), plus the self-employed contribution to Social Security. This labor amount does not include any amount for additional benefits such as paid vacation or retirement contribution. Thus your labor cost is \$17.25 per bowl.

Materials cost is \$2 per bowl.

Your overhead costs are \$40 per week.

You need a profit of \$40 a week for business expansion, inflation and investment.

## Method 1 - Four component

The price per bowl includes:

Labor + materials + overhead + profit = price

$$\begin{array}{r} \$17.25 + \$2 + \$2 + \$2 = \$23.25 \\ \text{per bowl} \end{array}$$

This will give you the wholesale price—the price you would charge if you were selling to distributors or retail stores. Doubling the wholesale price will give you a retail price, which would apply if you were selling directly to customers.

# Home-based Business – Pricing

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Wholesale price  $\times 2 =$  retail selling price  
per unit  $\quad \$23.25 \times 2 = \$46.50$  per bowl

## Method 2 - Desired weekly wage

(Weekly materials + weekly labor)/number of units =  
selling price per unit.

( \$40 + \$300 ) / 20 = \$17 per bowl

The retail price for the bowl would be \$34.

This approach is often used because it starts with a reasonable wage. There is no allowance for overhead costs, inflation or profits.

## Method 3 - Cost of materials times 3

(Materials  $\times 3$ )/number of units = selling price per unit

(\$40  $\times 3$ ) / 20 bowls = \$6 per bowl

The retail price for the bowl would be \$12.

This formula (material times 3) is an approach often used by beginning product makers because it seems easy to calculate. There is no profit margin unless production time can be reduced and materials are relatively inexpensive and readily available.

## Other factors affecting price

In addition to the guidelines above, product makers setting prices should also consider several other factors:

**Location:** Where you sell affects the prices you can charge. You may get higher prices in urban, suburban and high-income areas.

Prices in rural and economically poor areas are generally lower.

**Skills:** If your production skills are above average, you can often get a higher price. This is especially true if customers appreciate and value your skills. Try to develop a product that is your specialty. Many customers are willing to pay for your expertise.

**Volume:** Time is money. If you can produce more items in less time without compromising quality, you'll have an edge over your competition.

**Timeliness:** Some products sell better at certain times of the year. Is your business seasonal? For example, gifts and Christmas decorations in October, November and December or candy near Valentine's Day and Easter.

**Quality:** People are usually willing to pay a little more for a well made product. Quality is never an accident. It is always the result of the will to produce something superior. Products that require more expensive materials and a special knowledge or technique will demand higher prices. One product maker says, "It takes just as many hours to make an item out of cheap materials as out of quality material."

**Value:** Seasonal items, fad items, unusual and imported items bear higher prices because of their perceived desirability by customers. If you have ever purchased a fad item (Star Wars or pet rocks, for example), what do you think the cost to the producer was? How much was the profit margin? This practice — inflating the profit margin to take advantage of trends

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or fads — is called “skimming the market.” In most cases, the item has a very short life. The opposite of skimming the market is called “penetration pricing” — setting one’s prices abnormally low to become established in a market. Price is often the indicator by which customers judge quality.

## Inflation and increased overhead:

The cost of doing business rises periodically and predictably. The amount charged by your suppliers will be out of your control. Because customers resent frequent price changes, you need to set prices that cover these changes. Estimating the cost of replacing inventory/materials in the future must be part of every pricing decision. When costs suddenly rise, what will be the effect on volume of sales and customer loyalty of “passing through” higher costs to the consumer? Would it be better policy in the long run to give up some or all the profits on a service by absorbing the higher costs while keeping prices stable? Can you afford to do this?

**Markdowns:** Occasionally you may have to offer markdowns, specials or discounts to increase business. Have you set prices high enough so you do not incur a loss when you discount an item?

**Break-even point:** The break-even point is the minimum amount you can charge simply to cover the costs of running the business. To calculate the break-even point, determine what the direct costs (materials, labor) per product are. Then estimate one year’s total fixed expenses for the business (overhead).

For example, you can plan to sell a new product for about \$25 each. You know that your material and labor cost per product will be \$10. The difference between the selling price and the product’s direct cost is \$15. This is your per item contribution to fixed costs. Up to your break-even point, every penny of this amount has to go toward covering your fixed expenses. You estimated your annual overhead at about \$3,000. Now divide annual overhead (\$3,000) by your contribution to fixed costs.

$$\begin{array}{r} \text{Annual overhead /contribution to fixed cost} = \text{number} \\ \text{of sales} \\ \hline \$3,000 \quad / \quad \$15 \quad = \quad 200 \end{array}$$

Now you know the number of products you need to sell to break even on this particular product. You would break even when you had produced and sold 200 items.

**Legal constraints:** Federal, state and local laws regulate pricing on some goods. Federal laws prevent deceptive pricing and pricing that limits competition within a given market. State laws, called fair-trade laws or unfair sales practice laws, specify prices below which a retailer may not sell a product.

**Competition:** The price charged by local competitors is relevant to the price you can charge. You want customers to buy goods from you, not your competitor. Do some market research — investigate what is being sold and how much is being charged in your area. The bottom line is competition. You have only three pricing strategies compared to your com-



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petition; higher, lower or the same. If you are either higher or lower, you need to explain why.

Price is one of the most important factors that directly influence a business's profit or loss. The others are costs and sales volume. All three must be in the proper proportions for you to obtain your desired profit. No one pricing strategy will work under all conditions. Prices can be changed when market conditions warrant. But they should be set as carefully and accurately as possible and should always cover costs.

Adapted From: "Setting A Price," Barbara R. Rowe, Ph.D., family resource specialist, and Marion T. Bentley, Ph.D., business and economic development specialist, Utah State University, 1987.

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