



Five Common Startup Money Mistakes

It's easy to go wrong when mapping out financials for a new venture. Here's how to avoid some typical potholes.

Figuring out the financial details of a new venture can seem a mix of aspiration (How much I'd like to make. . .) and folly (I need borrow how much?). But writing down numbers on paper and as accurately as possible is important. It can provide a map to show where you are trying to go and what it will take to get there. It can also reassure investors, employees and yourself that you thought things through, did your research and have a realistic view of what your business needs.

But it's easy to go wrong when mapping out a financial plan, especially on first-time ventures. Here are five finance-related mistakes entrepreneurs often make and how to avoid them.

1. Underestimating operating costs

About a third of new business owners said they underestimated their monthly expenses, according to a recent survey by insurer Hiscox USA. While founders remember the obvious expenses, they often forget related items that can quickly add up. For example, if you make a product, you also have to package it. If you need a car or truck for business, you also need auto insurance.

Often, entrepreneurs who have employees factor in wages but forget about payroll withholdings, like Social Security, Medicare, unemployment insurance, and income-tax, says Raffaele Mari, an accountant in Newport Beach, Calif., who teaches a financial course for entrepreneurs at Pepperdine University. These expenses can increase employee costs by up to 25%.

The fix: Mari recommends using a worksheet, such as SCORE's 12-month cash-flow worksheet: http://www.score.org/downloads/12_Month_Cash_Flow.xls

Download previous free special reports on small business here: <http://bbetips.com/specialreports.html>

BUSINESS BUILDER SPECIAL REPORT



When Hajo Engelke launched Custom Choice Cereal, a gluten-free-cereal company in Durham, N.C., he looked at annual reports for publicly traded companies such as General Mills and Kellogg's to see what their expenses were. "Look at the line items they have. The numbers will be different from yours, but the categories of expenses will be the same," says Engelke, who launched his three-person company in 2009.

To get an idea of what your costs will be, ask vendors what they'll charge you initially and what discounts they can offer as you buy in larger amounts. Talk to people in your line of business who aren't direct competitors about what their expenses are and what they spent starting out.

- Related: Sample Cashflow Worksheet: <http://www.entrepreneur.com/formnet/form/483>

2. Underestimating startup costs

Nearly a fifth (18 percent) of small-business owners said they didn't secure enough financing when they were starting out, according to the Hiscox survey. One problem: Entrepreneurs are routinely too optimistic about how quickly sales will build and their business will sustain itself. They often mistakenly believe that as soon as they close a sale they'll have money. "They forget that people won't pay for 30 or 60 days and might be late," Mari says.

The fix: Engelke advises entrepreneurs to follow the "rule of two." "Expect everything to take at least twice as long and cost twice as much as you planned," he says. The exception is revenue. Divide your revenue estimate by two. "Because it will be half of what you're planning on," says Engelke, who mentors local business owners and judges business-plan competitions. When you're trying to gauge how much to borrow, estimate not just start-up expenses, but how much cash you'll need to cover your day-to-day expenses while you build.

Estimating higher costs, lower revenue and a longer time to viability may lead to a sum that might seem intimidating, and you might feel that the bank is more likely to turn you down if you ask for a higher figure. But above all, a banker wants to see a realistic plan. Entrepreneurs who borrow the amount they really need, no matter how large, are more likely to survive and grow than entrepreneurs who borrow less than they need and run out of money too soon.

Download previous free special reports on small business here: <http://bbetips.com/specialreports.html>

BUSINESS BUILDER SPECIAL REPORT



- Related: Sample Startup Costs Worksheet:

<http://www.entrepreneur.com/formnet/form/131>

3. Mispricing products or services

New entrepreneurs often arrive at a price for their product or service by adding up their costs and adding on the margin they think they ought to make. The approach is typically too simplistic and ignores important factors like market position and the real value of your product.

The fix: Before putting a price on a new product or service, decide first how you'll position it. Will you be the low-cost, mass-market provider, create a high-priced premium or niche product, or offer a value product that combines reasonably good quality and a relatively low price?

"Price your product or service at a point that reflects its value," Engelke says. "Then look at whether you can justify the costs it will take to produce it." Do a traditional cost-based or "bottom up" pricing analysis and a "top down" analysis, where you start with price and work backward. Then place each estimate next to each other. This exercise can help you get to the most realistic numbers.

When Engelke did that, he saw a big discrepancy in his pricing. "I'd made the wrong assumptions about how much volume I would need to get to break-even," he says. To avoid pricing his product too expensively, he also reconciled himself to narrower margins than he'd planned until sales volume is large enough to lower the costs of his ingredients.

- Related: Sample Price Estimate Worksheet:

<http://www.entrepreneur.com/formnet/form/111>

4. Miscalculating the break-even point

Entrepreneurs often don't distinguish between fixed costs, such as rent and utilities, and variable costs such as workers, materials, packing and shipping. As a result, they wrongly

Download previous free special reports on small business here: <http://bbetips.com/specialreports.html>

BUSINESS BUILDER SPECIAL REPORT



assume all their costs will stay steady as their sales grow, and they plan for their profit margin to widen much faster than is realistic.

The fix: Use a worksheet, such as those included in SCORE's financial projections template to sort out which costs related to your business are fixed (they stay steady regardless of how much business you do) and which are variable (and will rise as your sales grow). Then make sure the latter increase in step with your sales in any forecasts you make.

"At some point, they will go down on a per-unit basis," Engelke says. "But for a while, they'll go up."

- Related: Profit-and-Loss Forecast Worksheet:

<http://www.entrepreneur.com/formnet/form/936>

5. Not budgeting for their own salary

Engelke says that that when he judges the Carolina Challenge business-plan competition, he routinely sees entrepreneurs leave a salary for themselves out of all the financial projections.

"They say, 'I'm not going to pay myself,' and that's true, for a while," he says. But entrepreneurs who don't write in a target salary for themselves are keeping their expenses and break-even point artificially low. "At some point you need to pay yourself," he says.

The fix: Entrepreneurs should add a founder's salary into the financial picture by nine-month mark, even if the business isn't yet throwing off the cash to pay it. "On the balance sheet, it's deferred compensation, but you're acknowledging your value to the business and what you want to get out of it eventually," he says.

By adding this number to your data, "You get a more honest picture of where you need revenue to get to and when you'll hit break-even. And it forces you to be honest about the business's prospects," Engelke says. If you doubt the business can generate enough money to pay the salary you want and think you're worth, you might be better off starting a different business or doing something else entirely.

He says, "No one else would run your business for free, so you shouldn't, either."

Download previous free special reports on small business here: <http://bbetips.com/specialreports.html>

BUSINESS BUILDER SPECIAL REPORT



- Related: Sample Development Budget Worksheet:

<http://www.entrepreneur.com/formnet/form/126>

Source: Entrepreneur | <http://www.entrepreneur.com/article/printthis/219368.html>

Download previous free special reports on small business here: <http://bbetips.com/specialreports.html>

Download previous free special reports on small business here: <http://bbetips.com/specialreports.html>