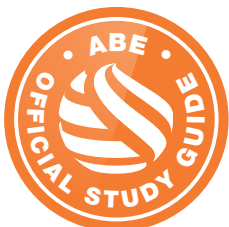


Your road to success

**ABE LEVEL 2
AWARD IN SETTING
UP YOUR OWN
BUSINESS**



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Using your study guide

Welcome to the study guide for the **ABE Level 2 Award in Setting up your own Business**. Below is an overview of the elements of learning and related key capabilities (taken from the published syllabus), designed to support those who are considering setting up their own business and being self-employed.

Element of learning	Key capabilities
Element 1: Self-employment as a career choice	<ul style="list-style-type: none"> Formulating the arguments for and against setting up your own business
Element 2: The business proposition	<ul style="list-style-type: none"> Outline the business proposition – what is the best method of operation, what makes you different from others, who are your customers and how will you get yourself noticed
Element 3: Personal success and survival in self-employment	<ul style="list-style-type: none"> Identify opportunities for business start-up finance and manage income and expenditure on an on-going basis to meet personal and business monetary needs
Element 4: Business finance and recordkeeping	<ul style="list-style-type: none"> Identify the requirements for financial recordkeeping in self-employment and identify relevant accounting source documents to meet recordkeeping needs

This study guide follows the order of the syllabus, which is the basis for your studies. Each chapter starts by listing the learning outcomes of the course and the assessment criteria. This course is a Level 2 course. This means you will have the following level of knowledge and skills when you complete your learning.

Level	Knowledge descriptor (the holder...):	Skills descriptor (the holder can...):
Level 2	<ul style="list-style-type: none"> Has knowledge and understanding of facts, procedures and ideas in an area of study or field of work to complete well-defined tasks and address straightforward problems. Can interpret relevant information and ideas. Is aware of a range of information that is relevant to the area of study or work. 	<ul style="list-style-type: none"> Select and use relevant cognitive and practical skills to complete well-defined, generally routine tasks and address straightforward problems. Identify, gather and use relevant information to inform actions. Identify how effective actions have been.

In this study guide there are a number of features which we hope will enhance your studies.



'Over to you': Activities for you to complete – just print out the page and use the space provided. You can write out longer answers on a separate piece of paper.



Case studies: Realistic business scenarios to reinforce and test your understanding of what you have read.



'Revision on the go': Use your phone camera to capture these key pieces of learning, then save them on your phone to use as revision notes.



'Need to know': Key pieces of information that are highlighted in the text.



Examples illustrating points made in the text to show how it works in practice.

Tables, graphs and charts to bring data to life.

Source/quotation information to cast further light on the subject from industry sources.

Highlighted words throughout and **glossary terms** at the end of the book.

Note

Website addresses current as at March 2017.

Chapter 1

Self-employment as a Career Choice

Introduction

There are numerous reasons why individuals choose to become self-employed. In this chapter you will compare the benefits and drawbacks of being self-employed and consider these in relation to your own personal circumstances, needs and lifestyle choices. You will also look at the legal responsibilities of being self-employed, in the context of your local environment.

Learning outcomes

On completing the chapter, you will be able to:

- 1 Understand the benefits and drawbacks of self-employment based on individual personal circumstances and needs**
- 2 Demonstrate an awareness of the legal responsibilities of being self-employed in the local environment**

Assessment criteria

- 1 Understand the benefits and drawbacks of self-employment based on individual personal circumstances and needs**
 - 1.1 State the benefits and drawbacks of being self-employed based on own personal circumstances
 - 1.2 Identify own skills and qualities to manage self-employment
- 2 Demonstrate an awareness of the legal responsibilities of being self-employed in the context of the local environment**
 - 2.1 Outline the legal responsibilities of self-employment as a sole trader

ABE Level 2 Award in Setting Up Your Own Business

1.1 Why choose self-employment as a career option?

Why self-employment?

There are many reasons why you might choose **self-employment** as a career or decide to set up your own business. Perhaps you are an entrepreneur and want to be your own boss. Perhaps you haven't been able to secure suitable employment and simply need to survive harsh economic times. Perhaps you are looking for a way of balancing work with the demands of life – this can often be the case when care of dependants, such as children or elderly relatives, is a priority.

! NEED TO KNOW

An entrepreneur is someone who has had an idea or identified a gap in the market and sees an opportunity to do something better or differently to satisfy a consumer need.



The reality is that the need to become self-employed often stems from an inability to find stable, reliable employment. Indeed, some of the highest rates of self-employment are in the poorest regions of the world. By contrast, regions that enjoy a more stable economic performance have relatively low rates of self-employment. Poor economic circumstances inevitably lead to job losses and redundancies. In these circumstances, individuals are forced into self-employment.

Self-employment therefore may be seen either as an "opportunity" for job satisfaction, independence and a chance of higher income, or as a "necessity" forced on individuals by negative economic or external circumstances and the lack of paid employment. As mentioned above, self-employment might also stem from a desire to achieve a better **work/life balance**. Having control over your own workload means that you can manage the demands of work around commitments to family and others.

! NEED TO KNOW

The picture of self-employment varies across the world. Useful sources of information are:

The International Labour Organisation at www.ilo.org/ilostat

The World Bank at <http://data.worldbank.org>

Your own government's website.





OVER TO YOU

Activity 1

Find out some self-employment statistics for your country.

Types of self-employment

The term self-employment is used generally to describe the employment status of someone who works, but is not employed (by an employer). They find their own work rather than being directed by someone else.

Other terms used in conjunction with the self-employed are as follows:

- **Sole trader:** Sometimes referred to as **sole proprietor**, this term is used to describe the legal structure of the business. It is the simplest and most common form of business structure and refers to the single owner of a business. A sole trader is legally responsible for the debts of the business and personal assets may be taken to cover any money owing. This is covered later in this chapter. Examples of a sole trader may be an independent retailer, taxi driver, smallholder, baker or hairdresser.
- **Contractor:** A contractor is a self-employed person who undertakes to supply materials, goods or services to someone else (a client) at a mutually agreed price within a specified time period. The duration of the contract will vary depending on the nature of the service, however once the terms of the contract have been fulfilled the contract ends. A contractor may have one single client or a number of clients at the same time. Typical trades for contractors include plumbers, builders and cleaners.
- **Freelance:** Working as a freelancer is similar to being a contractor in that you work independently for a number of people selling your work or services either by the hour, day or project. You are hired at an agreed rate or fee for a specific assignment. The term however, is more widely used where individuals work in an artistic or creative field such as independent journalists, photographers or artists.
- **Working from home:** Also known as **homeworking**, this indicates that the self-employed person's business is carried out in their own home. Homeworkers are often contracted for a specific job or assignment and paid by the hour, day or job, just like contractors and freelancers. Examples of homeworking opportunities include child-minding, direct selling, online tutoring or website testing.

Maslow's Hierarchy of Needs

We have seen that the decision to become self-employed can be based on opportunity, necessity or a desire for a better work/life balance. Whatever the underlying motivation, such choices are based on need. Maslow's Hierarchy of Needs is a motivational theory proposed by Abraham Maslow in 1943 in his paper *A Theory of Human Motivation*.

The hierarchy has five stages and each of the stages represents a set of needs. Each stage must be satisfied before an individual can move onto a higher stage. Movement through the stages of the hierarchy can be either upwards or downwards. If the factors that satisfy the lower stages are taken away we will no longer be concerned with the higher stages.

A self-employed person will need to be satisfied that their business proposition is sufficient to maintain their standard of living and provide for themselves and their families before launching a new idea. If the business idea fails to provide these lower orders, the motivation to expand and develop the business further will be lost.

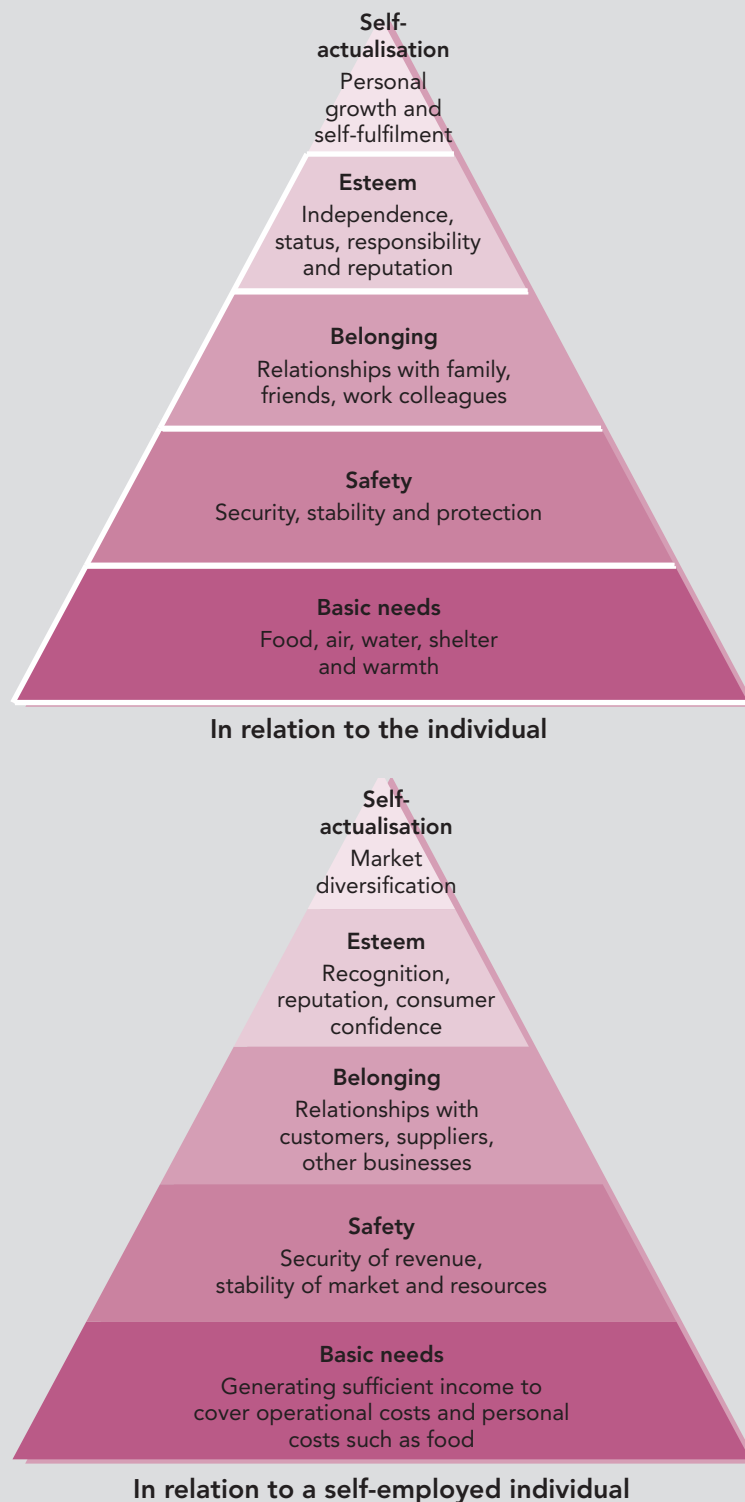


Figure 1: Maslow’s Hierarchy of Needs



When considering self-employment as a career option it is important to compare the benefits and drawbacks to being employed.

Feature of employment	Employee	Self-employed
Income	You are paid a weekly or monthly sum of money. You have security as you are able to plan your finances.	Your income will be directly related to your business efforts. Income may fluctuate from one month to another and there may be periods where you do not earn.
Holiday pay	You will probably be entitled to a specified number of paid days holiday per year. You may also be paid for public holidays and weekly rest days.	If you are not working you will not receive any income whilst on leave unless you have employees who maintain the business activity in your absence.
Sick pay	Employers may continue to pay you for a reasonable amount of sickness days per year.	If you are sick and cannot work you may not be paid.
Healthcare	Some employers provide their employees with a healthcare plan which will give them access to treatments and high standards of care.	If you want access to specialist treatments and private healthcare you will have to pay for it yourself through a personal scheme.
Pension	Many employers will provide employees with access to an occupational or workplace pension in addition to any state pension.	You may be entitled to a state pension. However, if you want to create additional retirement funds you will need to pay into a private personal pension.

Table 1: The benefits and drawbacks of self-employment (sole trader) compared with employment



Table 1 seems to portray a negative picture of self-employment in which there are very few benefits. However, as you will see below in Table 2, working for yourself also brings opportunities for greater autonomy and choice in terms of your working activities.

Flexibility and choice	You will need to work sufficient hours to make enough money to meet your financial commitments and you will be able to decide when you work, how often and for how long. However, many self-employed people find that they end up working longer hours than they anticipated.
Self-esteem	Self-esteem is important for productivity and effectiveness. Building a successful business can be empowering and lead to greater self-esteem. However, it can also have the reverse effect if you or your business receives negative feedback from its customers. The growth of social media has resulted in more opportunities for unsatisfied customers to air their views and opinions in public.
Job satisfaction	Job satisfaction can be measured in two ways. Firstly your contentment with the tasks and activities that you are performing in your daily work and secondly your contentment with the conditions in which you work, such as the workplace environment and the people with whom you work. As a self-employed person you will have direct control over these factors.



Control over work

A self-employed person makes all the decisions relevant to their business and therefore has control of the work that they as an individual and the business undertake. However, they also need to be able to plan ahead and make sure that the volume of work is constant and consistent. This is sometimes difficult if the work is seasonal. Periods of no work or limited demand for your services will cause worry and stress if you do not plan for them properly.

Realisation of an idea

Seeing an idea come to fruition can be very rewarding. Success may not be instant and it may take some time for your ideas and innovations to achieve recognition and reward.

Table 2: Autonomy of self-employment



Sources of advice

Before taking the decision to become self-employed it is advisable to seek the advice and opinions of others. There are many people who will be able to help you consider the best options for you:

- **Professional sources:** These include accountants, solicitors and financial advisers. Accountants will be able to provide you with advice about taxation and your legal financial obligations. A solicitor will be able to advise you on any legal aspects related to your particular business, and a financial adviser could suggest ways of financing your business.
- **Business networks:** These are specifically designed to bring business people together and provide opportunities for businesses to promote their products and services to other business people. Chambers of Trade or Commerce are usually represented locally and help small businesses to discuss local and national issues that are impacting their business. Other business networks are operated over the internet, such as LinkedIn. They enable focus groups on specific topics and discussion forums to aid problem solving.
- **Family and friends:** You will want to be sure that you have the support of your family and friends before starting a new venture, particularly close family members, as your choice to go self-employed may have a direct impact on them. Not only are they likely to give you honest advice, but in many cases, it will be family and friends that provide business start-ups with the necessary finance to get the business off the ground.
- **Other self-employed people:** It is a good idea to research similar businesses and talk to other self-employed people about their experiences.

! NEED TO KNOW

You can start by looking at businesses in your local area, but a simple internet search will reveal groups and organisations which have been purposely set up to support the self-employed, such as The Freelancer Club (<https://freelancerclub.net>) or Freelancer (www.freelancer.com).

These organisations will put you in touch with other freelance workers, as well as providing you with the opportunity to advertise your own services.



- **Business coach:** A business coach will work with you to explore your strengths and improve your weaknesses, to support you with your business growth. They offer impartial advice, and may offer business coaching seminars and training, although this usually comes at a cost.

 OVER TO YOU
Activity 2

Identify sources of advice in your local area and write down some contact details below.

Professional sources	
Business networks	
Other self-employed people	

1.2 Skills and qualities needed to manage self-employment

Personal skills and qualities

You will need a lot of courage to take the first step into self-employment. Having a good idea, being good at something or having a particular skill or talent is not enough to launch a successful business. Some of the key skills and qualities you need are described below.

Personal skills and qualities	Description
Motivation	Motivation is fluid, in that it can change based on circumstances, as illustrated earlier by Maslow's Hierarchy of Needs. There are likely to be some setbacks as your business gets established and you need to make sure that you have the motivation to continue.
Hardworking	You will need a strong work ethic because you are likely to need to work very hard, and for long hours. That means that you will need to enjoy the work that you do. You will also need the stamina and enthusiasm to continue striving for your goals even when you face challenges.
Willingness to learn	You are the most valuable resource in your business and you need to continually learn and improve for your business success. You can learn by reading magazines, reports, journals and publications. Investigate other businesses' websites to see how your competition operates.
Realism	Being realistic means setting business goals and achievements which, whilst challenging, are attainable.
Focus	You will need to focus on what will make your business a success and do this well. It can be easy to get distracted and lose sight of the main objective of your business, particularly in response to suggestions and criticisms from others. Setting realistic goals will help you to stay focussed.

Table 3: Personal skills and qualities needed for self-employment



 OVER TO YOU

Activity 3

Now assess your own personal skills and qualities using the grid below. Score each one between 1 and 5, where 1 is an area that needs a lot of development and 5 is a core strength. Be honest so that you can truly assess your skills and qualities to be self-employed.

Personal skills and qualities	Score					Comments
Motivation	1	2	3	4	5	
Hardworking	1	2	3	4	5	
Willingness to learn	1	2	3	4	5	
Realism	1	2	3	4	5	
Focus	1	2	3	4	5	

Everyone has areas that they could improve and develop. From your assessment above, write down the main areas that you wish to improve and think about how you might develop them.

Business skills

As well as having personal traits and attributes indicated above, you will also need business acumen in order to run your business successfully. You will either have to learn and develop particular skills (if you don't already have them) or **outsource** them to an expert.

 NEED TO KNOW

An example of outsourcing is when an accountant prepares a personal annual tax return on your behalf.



Table 4 indicates some of the main business skills needed in self-employment.

Business skill	Description
Bookkeeping	You will need to manage your incomings and outgoings in order to make a profit. This will involve systematic and regular recordkeeping.
Marketing	Marketing involves communicating the value of your product or service to the customer. This does not just mean placing advertisements and distributing leaflets. To be effective in marketing you need to know the impact of your product (or service), its price, how it is distributed and how it is promoted to your customer.
Sales	The sales function consists of the customer-facing activities which deal directly with the person buying the product or service. Essentially, selling refers to engaging the customer's attention, presenting the item for sale, agreeing the purchase value and closing the sale.
Business development	You may need to develop new products and services to meet customers' needs, expand into new or diverse markets and generate new business opportunities.
Customer management	Customer management or service deals with providing a service to the customer before, during and after the purchase of the product or service. The key focus is making sure that the customer's needs and wants are met to enhance their satisfaction. It will also mean dealing with customer complaints and resolving issues to both the customer and business satisfaction.
Information technology (IT)	There are few businesses that do not use some form of technology somewhere within their business operations. Many businesses also use a range of software applications for general administration, storing information about their customers or for carrying out specialist functions such as computer-aided design (CAD). Most modern organisations also have a website to promote their products and services, while others use social networking, such as Facebook, to reach a target audience.
Administration	Being able to plan ahead, organise paperwork and keep accurate records are essential skills for a self-employed person. This demands a high level of self-discipline to keep up to date with the administrative needs of the business.
Time management	As a self-employed person you should be able to manage your time as many self-employed individuals find they work longer hours than they anticipated. Effective time management is about planning the amount of time you spend on specific activities within your business.

Table 4: Business skills needed for self-employment





OVER TO YOU

Activity 4

Now consider your own business skills and complete the grid below. Rate your skills between 1 and 5, where 1 is an area that needs significant development and 5 is one of your core strengths.

Business skills	Score					Comments
Bookkeeping	1	2	3	4	5	
Marketing	1	2	3	4	5	
Sales	1	2	3	4	5	
Business development	1	2	3	4	5	
Customer management	1	2	3	4	5	
Information technology (IT)	1	2	3	4	5	
Administration	1	2	3	4	5	
Time management	1	2	3	4	5	

From your assessment above, write down the main business skills that you wish to improve and think about how you might develop them.

Psychological impact

Finally, you need to consider what the psychological impact of self-employment on your health and well-being will be. You may experience a sense of freedom, but self-employment can create additional pressures because of:

- irregular income
- work overload
- long hours.
- reluctance to take time off
- isolation

Strategies for dealing with self-employment pressures are as follows:

- **Learn to budget:** Know when you can expect expenditure and put aside income to cover these costs. Don't be tempted to spend all your money as it comes in.
- **Know your limitations:** Don't overcommit, because if you cannot deliver on a promise it may result in complaints and negative feedback which will put added pressure on you.
- **Network with others:** Taking time to meet with other self-employed people either informally or through formal business networks can bring opportunities to share ideas and learn from other business owners.

- **Take time off:** You will need to rest, relax and recharge your batteries at some point, so don't be afraid to take holidays or days off. If you are working from home, separate your business area and your living area so that you can physically come 'away' from work.

Throughout your working life you will have developed skills that can be transferred to other work. Consider this further by looking at the following case studies and completing the activities that follow them.

 CASE STUDY

Work/life balance

Eby is a mother of three children aged three, six and eight. Her first job was working as a beautician at a large spa hotel in the city centre. As well as carrying out treatments on clients she also took bookings over the phone, greeted customers on arrival and handled payments. She worked long hours in the spa and her shift pattern meant that she often had to work in the evenings.



Eby took a career break and is now looking to return to work but doesn't want to go back to full-time employment. She is considering becoming a self-employed mobile beauty therapist.

 OVER TO YOU

Activity 5

Using Eby's case study information, complete the sections below.

Personal and business skills that she developed in her first job that may be useful now	Benefits of self-employment
Skills she might need to develop	Drawbacks of self-employment

CASE STUDY

The benefits of self-employment

Issac has been a highly successful salesperson for the same soft drinks company for the past ten years. He regularly receives a bonus for exceeding his monthly targets. He spends most of the working week driving around the region meeting clients, promoting products and negotiating sales contracts. As a result he spends a lot of time on the road and many nights in hotels away from his family.



Unfortunately, despite his success as a salesperson, the business is closing and his employer has told him that he will be made redundant at the end of the month. As a long-standing employee he will receive a redundancy payment from his employer.

Issac is worried about paying his mortgage as there are few sales jobs currently available in his local area. He is considering becoming a self-employed taxi driver.

OVER TO YOU

Activity 6

Using Isaac’s case study information, complete the sections below.

Personal and business skills that he developed in his sales job that may be useful in his new job	Benefits of self-employment
Skills he might need to develop	Drawbacks of self-employment

2.1 Legal responsibilities of self-employment as a sole trader

Sole trading

The legal responsibilities of being self-employed as a sole trader may vary a little from one country to another but generally have the following features.

- **Legal structure:** Being a sole trader means that you are running your own business as an individual rather than a legal entity, therefore there is no legal distinction between you and the business. It is the simplest form of business structure and easiest to set up as there are limited legal formalities that govern its formation. A sole trader can trade under their own name or a fictitious business name and, in most cases, there is no requirement to register the trading name. Sole traders cannot raise money publicly from the sale of shares and may find it difficult to attract outside funds in the form of loans from banks, as lending decisions will be based on the sole trader's personal credit rating.
- **Financial responsibility:** A sole trader has legal responsibility for all aspects of the business and must keep records of the business' sales and expenditure for taxation purposes. As a sole trader, all your business' profits pass to you after you have paid personal tax on them. You will need to submit a personal tax return at the end of the financial year. Only expenses incurred in the production of the business income, such as wages/salaries, materials, business insurance, premises rental, premises utilities and interest on loans, are allowable against business income. Domestic and personal expenses, such as personal electricity and water, clothes and the purchase of personal assets, are non-allowable.
- **Legal responsibility:** You can employ staff, but the responsibility for the business and your employees' actions remains with you. You are also personally liable for any injury caused to others through your negligence or through accidents on your premises. As a result, a sole trader may be personally sued for damages and compensation.
- **Unlimited liability:** A major disadvantage of being a sole trader is that you have unlimited liability and will be personally responsible for any losses your business makes, so, if the business fails and you owe money to others (your creditors), you may find that your personal possessions will be seized to pay the debts.



OVER TO YOU

Activity 7

Find out the specific legal and financial responsibilities of being a sole trader in your country.

Insurances

Sole traders are advised to take out **public liability insurance** which is designed to cover you if a customer or member of the public makes a claim for compensation, after suffering a loss or injury as a result of the business activities.

If a sole trader gives advice, offers a professional service, such as management consultancy; handles data or intellectual property belonging to a customer or client, such as a writer; they are advised to take out **professional indemnity insurance**. This is designed to protect the sole trader if a client makes a claim against them that arises from an act, omission or breach of professional duty in the course of their business.

If you employ people, you may be required to have **employer's liability insurance** (sometimes referred to as workers' compensation insurance) which provides cover for claims made by employees who are injured or become ill as a result of their employment with you.



OVER TO YOU

Activity 8

What insurance might you need to protect you and your own business?

Chapter 2

The Business Proposition

Introduction

Setting up as self-employed is not an easy option. You will need to think carefully about the viability of your business proposition, the demand for your products or services, how you will operate and how you will get yourself known. In this chapter, you will consider your business proposition and whether becoming self-employed is a viable option for you.

Learning outcomes

On completing the chapter, you will be able to:

1 Outline the business proposition

Assessment criteria

1 Outline the business proposition

- 1.1 Use relevant information and data to determine the key elements of the business proposition
- 1.2 Identify how to attract potential customers

ABE Level 2 Award in Setting Up Your Own Business

1.1 The business proposition

Now that you have thought about your own skills and qualities and considered the benefits and drawbacks of being self-employed, the next thing to decide is the key elements of your **business proposition**. This will mean thinking about what you are offering (product or service), how you are going to get it to your customers and what makes you different from others providing a similar product or service. Understanding the current and future market in which you will operate is crucial to your business success.

Market research

Researching the market involves collecting and analysing data and information relating to the market and consumption of goods and services. There are many different ways of carrying out **market research** but they all have the common aim of contributing to good business planning through well-informed decision-making.

Market research can generally be categorised as:

- **Primary or field research:** This involves gathering information for the first time and usually for a specific purpose. This is information obtained directly from your customers (existing or potential), suppliers, and other businesses including your competitors, although they may not know it. The best way to find out what people think of your idea and what they think of your competitors is by asking them. Conducting primary research can be expensive and time-consuming; however, you will gain valuable information about your customers' preferences, needs, wants and opinions.

Some common approaches to primary research include:

- survey and questionnaires
- interviews
- focus groups
- observations.
- **Secondary or desk research:** This uses information and data gathered from another source or third party. It is generally less expensive than primary research as the information is readily available and accessible. As a result, many business owners carry out secondary research before embarking on more costly primary research techniques.

Some common approaches to secondary research include reviewing:

- websites and the internet
- trade journals
- newspapers and magazines
- consumer market analysis reports – such as Mintel.

The data and information obtained from market research can be categorised into two types – quantitative and qualitative.

Quantitative data produces statistical and numerical results that may show market information relating to the size of the market, trends and financial indicators. Such information is useful to support business decisions, but gives you little information about the real opinions and preferences of your customers.

Qualitative data is obtained through talking to people, either in one-to-one interviews, or in small focus groups where individuals feel comfortable to express their opinions and views. Qualitative data is most valuable in understanding your potential market.



OVER TO YOU

Activity 1

Think about what market research methods will be relevant to your own business proposition. Make a list of whether they are primary or secondary, and whether they will result in quantitative or qualitative information.

Physical offering

Your **physical offering** is something that satisfies a customer's needs. It may be a physical product, also known as "goods", or it may be a service.

A physical product is **tangible** in that the customer can see, touch or smell it. Examples include clothing, food, jewellery and mobile phones. A service is **intangible** in that the


customer cannot see or touch it before they buy it. Examples include insurance cover, downloadable music, mobile phone apps or a haircut. Many businesses sell both tangible and intangible elements. Whatever the case, consumers will buy a product or a service based on the benefits that it brings to them.

For example, when you buy an item of clothing, you probably buy on the basis of its tangible features, such as fit, colour, warmth, protection, etc. In addition, you may seek related intangible services such as a good returns policy in case you change your mind about your purchase.

Table 1 considers the tangible and intangible elements of a restaurant business:

Tangible elements	Intangible elements
Quality of the food	Reliability of quality
Proficiency of the service staff	Responsiveness of service staff
Layout and design of the restaurant	Ambience of the restaurant
Cleanliness	Assurance of quality
Location of the restaurant	Empathy of staff

Table 1: Tangible and intangible elements of a restaurant business



 OVER TO YOU

Activity 2

Think about the following business proposition. What are the tangible and intangible elements of each product or service?

Business proposition	Tangible	Intangible
A second-hand car sales showroom		
A business that builds bespoke computer systems		

Method of operation

Method of operation refers to how you are going to get your product or service to the customer. This may also be referred to as “distribution” or “place”. You may be planning on operating from home (see homeworking in Chapter 1), from fixed business premises, such as a retail outlet or office, or by offering a mobile service by taking your product or service directly to your customer. You may also offer your product or service online.

Method of operation	Advantages as a business proposition	Disadvantages as a business proposition	Examples
Working from home	<ul style="list-style-type: none"> Low running costs Easy to start up 	<ul style="list-style-type: none"> May be more difficult to get your product/service known as it is less visible to consumers 	<ul style="list-style-type: none"> Authoring and content writing Language translation services Website design Market research and telephone surveying Fundraising
Fixed business premises	<ul style="list-style-type: none"> Visible and accessible to consumers Easier to develop brand recognition 	<ul style="list-style-type: none"> High running costs Legal and contractual implications of property ownership or leasing 	<ul style="list-style-type: none"> Retail Hairdressing Beauty therapy Vehicle maintenance Childcare
Mobile service	<ul style="list-style-type: none"> Convenient for consumers No premises costs 	<ul style="list-style-type: none"> Increased travel costs Unpaid travel time to and from jobs May require specific transport facilities such as a van 	<ul style="list-style-type: none"> Cleaning services Gardening General building Plumbing Carpentry Taxi driving
Online	<ul style="list-style-type: none"> Global opportunities Easy to update to meet consumer needs Available to consumer 24/7 	<ul style="list-style-type: none"> May be more difficult to get your product/service known, as less visible to consumers 	<ul style="list-style-type: none"> Online selling Online tutoring Blogging

Table 2: Advantages and disadvantages of methods of operation



How you choose to distribute your product or service will have a significant impact on what you are going to charge for it. If you need expensive premises to run your business you will need to cover these costs. So, when setting prices, you need to cover the costs of operating, as well as the cost of producing your product or service, plus how much profit you wish to make. You also need to think about what your competitors are charging for a similar product or service. If you set your prices too high in comparison to your competitors it is unlikely that customers will buy from you. Most importantly you need to know what the customer is willing to pay.

Pricing strategies

Establishing and setting the right pricing for products and services is essential for a business success. High prices do not necessarily discourage customers, whilst low prices do not always guarantee high sales. The price that is set for a product must be sufficient to cover the cost of producing the product or service. It is also essential to consider what the business competitors are charging for a similar product or service and also how much profit the business wants to make. Most importantly a key factor is understanding what the customer is willing to pay and how many products might be sold.

There are a number of different strategies that you can use when deciding the price of your product or service:

- **Loss leader:** This is a strategy of pricing a few products at a low price to capture the sales and encourage customers to buy other products from the business. This strategy is often used in situations where the business offers a range of products that complement each other, such as printers and print cartridges. The loss or reduced profits on one product are compensated for by selling other products which are offered at a higher profit margin.
- **Price skimming:** This sets high prices for larger profit margins on low sales volumes. This is typically used when the customer is prepared to pay a high price for something unique or exclusive or because the price is of little concern to them. However, these customers are sensitive to quality and it is important to realise that a price skimming strategy will only succeed if the quality of the product meets the customer's expectations.
- **Promotional pricing:** This is used to generate demand for a new product by setting a relatively low price initially that is lower than similar products offered by competitors in the same market. This is only effective if the competition is unable to compete with the price, otherwise the competition could match or better it and this can lead to a price war.
- **Discounted pricing:** This is used to sell products in higher volumes. For example, discounts may be offered to customers that purchase in bulk or high quantities, for cash sales or prompt payments, and for customer loyalty. Businesses also offer seasonal discounts to customers who purchase items out of season or at a time other than during peak demand.

What makes you different?

A good starting point in understanding your business proposition in relation to competitors is to carry out a SWOT analysis. **SWOT** is an acronym for Strengths, Weaknesses, Opportunities and Threats and provides a framework for you to assess your business idea and decide on your business direction.

Completing a SWOT analysis is very simple and generally takes the shape of a matrix as shown on the next page. It is important to be realistic when considering the impact of the external environment on your business as well as your own internal strengths and weaknesses.

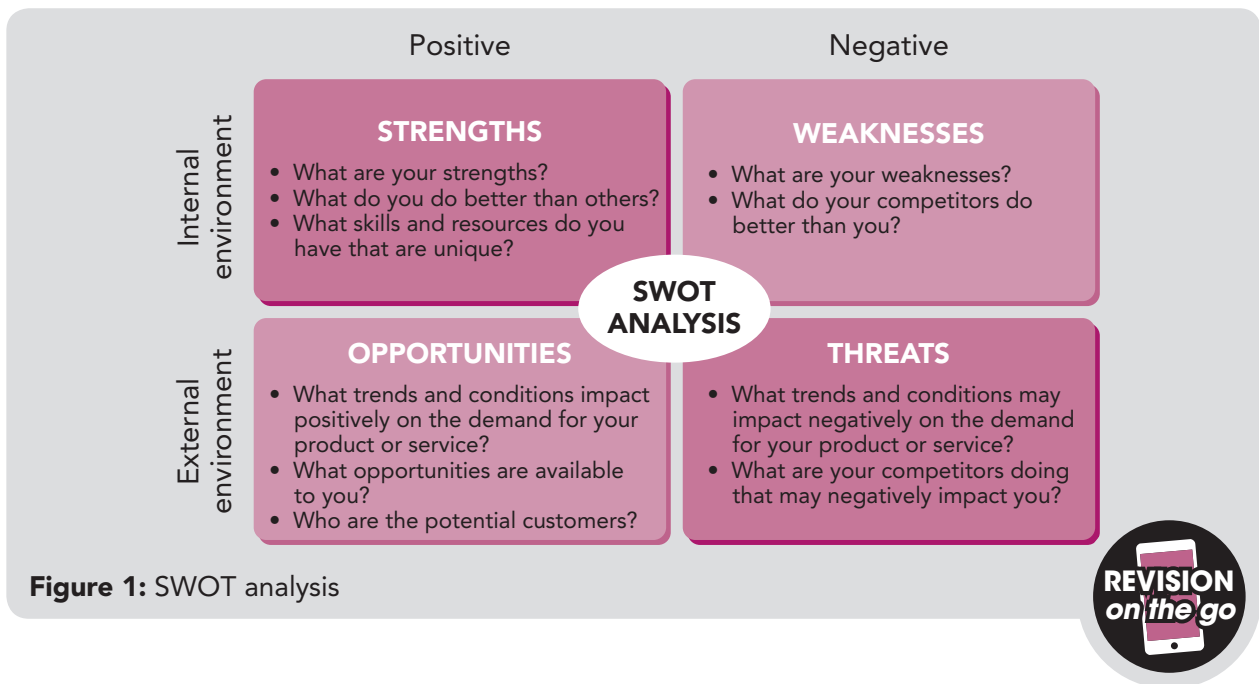


Figure 1: SWOT analysis

A SWOT analysis will help you to:

- **Exploit** your strengths and eliminate your weaknesses
- **Understand** your competitors so you can promote your unique position over your competition
- **Identify** your target market (your customers), a gap in the market, or an opportunity to take over from a failing competitor
- **Plan** contingencies to combat the impact of negative trends and conditions in the future.

! NEED TO KNOW

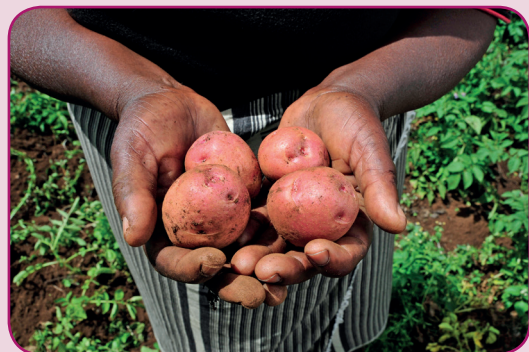
If a business is to be successful it has to stand out from the rest. A **Unique Selling Proposition** (USP) is what makes a product or service different from the competition. It is a factor or element that makes the customer choose your product rather than another. A SWOT analysis will help to highlight your unique selling proposition.



📄 CASE STUDY

The business proposition

Amani lives with his wife and three children on a smallholding. For the past ten years he has worked the land, providing a variety of vegetables to sustain his own family. In recent years he has extended the area he uses to grow potatoes and cabbages and has become so successful at farming that he now has more than he needs for his family. He is thinking about how he can make some money out of the excess produce.





OVER TO YOU

Activity 3

1 List some potential business propositions suitable for Amani.

2 Choose one business proposition from your list above and carry out a SWOT analysis of this idea.

1.2 How to attract potential customers

Knowing your customers

As a successful business person, you will need a thorough understanding of your customers' wants, needs, desires and preferences. You will need to know the "what, when, why and how" of how they make a purchase. You will need to be aware of the target market at which you are aiming your products and services. It helps to group or **segment** customers into various categories, each with its own characteristics and buying behaviour.

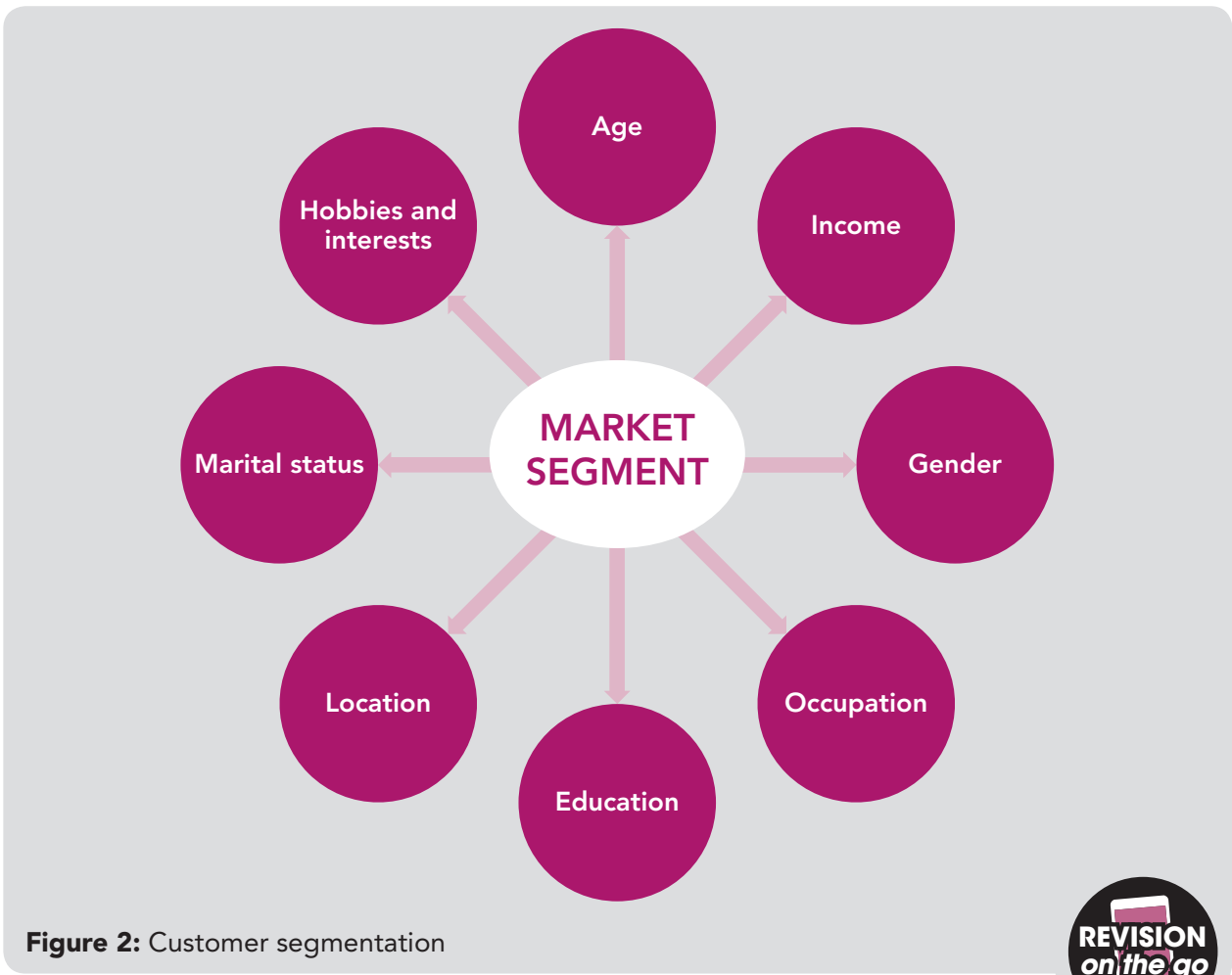


Figure 2: Customer segmentation

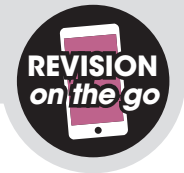


Table 3 shows some examples of customer segmentation:

Business activity	Target market
<p>Event organiser offering wedding planning services</p>	<p>Age – 20–40 years old Income – middle to high Gender – primarily female, although not exclusively Marital status – single and recently engaged Location – local</p>
<p>Teacher offering online English as a second language tutoring for children</p>	<p>Age – Marketing may be targeted at parents (34–50 years old), but should also be attractive to user (under 16 years) Income – middle to high Location – global Education – high</p>

Table 3: Examples of customer segmentation





OVER TO YOU

Activity 4

Now consider the following and identify their respective target markets.

Accountant offering personal tax assessment and preparation

Street trader selling homemade pastries from a market stall

Focusing on a customer segment enables business owners to develop products and services to specifically meet the customer's wants, needs and desires. The business owner will know where to promote these products and services and what the customers are prepared to pay.

Some ways in which you can improve your understanding of your customers' needs and wants are as follows:

- 1 Use **secondary research** to look for patterns and trends. If you have been established for a while, you will have lots of customer records and data to look at. If you are a new business starting up, then you can draw upon published records and data.
- 2 Use **primary research** such as **interviews and customer surveys** with existing and potential customers to find out exactly what they think of your product and service and how it can be improved. An anonymous survey may result in more honest opinions than a named interview. Be aware that some customers may tell you what they think you want to hear rather than what they are actually thinking. You may also consider offering gifts or incentives to encourage customers to give you feedback.
- 3 Experience your customer's experience for yourself by putting yourself in your customer's shoes and creating a **customer journey map**. Look at your premises from a customer's point of view – does it look clean, fresh, inviting? Review your communications (letters, email, website, promotional literature) – are they free from spelling mistakes, up-to-date, accurate, and informative? Ask someone else to experience your level of service either in person or over the phone and to feed back to you on their findings. Visit a competitor business and map your experience as a customer, then consider what you might be able to do better or differently.

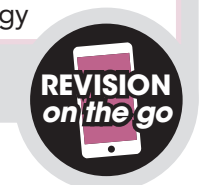
Getting yourself known

Nobody will buy your product or service unless they know it exists. There are many ways of communicating your business and its products to the market. Your personal image, your promotional literature and the way you maintain your business premises or offices communicate a lot of information about you.

The promotional activities you choose will depend on how much money you have available to spend on marketing.

Promotional activity	Examples	Comment
Advertising	Newspaper advertisements Brochures Leaflets and flyers Posters Billboards TV and radio advertisements	Can be expensive, especially media advertisements such as TV and radio Printed materials can become out of date quickly Brings your product or service to the consumer rather than them searching for you Difficult to measure conversion rates and therefore difficult to determine the efficiency of such methods
Public relations	Sponsorship of events or individuals Newspaper and magazine articles and press releases Newsletters	Builds strong relationships between businesses and their public Maintains a positive image with customers Boosts business credibility
Online tools	Websites Email marketing campaigns Online advertisements on other websites Search engine optimisation	Showcase your work Provide contact details and directions of where to find you Cost-effective way of reaching existing and potential customers Enable responses to comments, queries and complaints Can monitor and view statistics about how the consumer has viewed a webpage
Social media	Blogs Facebook Instagram Twitter	Easily reaches the target market Builds relationships with existing and potential customers Available 24/7 to consumers Generally free or low cost Can be time consuming to keep updating Can track number of hits, shares and re-posts, etc. Requires audience to have access to and ability to use internet technology

Table 4: Types of promotional activity



**OVER TO YOU****Activity 5**

Think back to Amani's smallholding and the business proposition with SWOT analysis that you carried out in the earlier exercise.

1 Suggest some appropriate promotional activities that Amani could use to communicate his idea and business proposition to his intended market.

2 Give reasons for your suggestions.

Chapter 3

Personal Success and Survival in Self-employment

Introduction

To make a success of self-employment, you will need sufficient funds to cover the costs of start-up, and you must be able to generate enough income on an ongoing basis to meet both your personal and business financial commitments. You should also be aiming to achieve sufficient profit to enable your business to grow. This chapter focuses on ways of managing your income, through setting charges/prices, and on ways of controlling costs to maximise profit.

Learning outcomes

On completing the chapter, you will be able to:

1 Understand the personal and business monetary needs for a business proposition

Assessment criteria

1 Understand the personal and business monetary needs for a business proposition

1.1 Identify potential sources of finance for a business proposition

1.2 Produce a personal success and survival plan/budget for individual circumstances

ABE Level 2 Award in Setting Up Your Own Business

1.1 Potential sources of finance for a business proposition

Assessing financial start-up needs

Starting a new business takes a lot of time and effort and, more importantly, money. Even if you are working from home you may still need to purchase equipment and materials to get you started. You will also need to make sure that you have sufficient funds to pay for your essential personal and business expenses until income starts coming in from your sales. This is known as **working capital**. Many self-employed people use their personal savings to finance a business start-up but if you do not have significant savings, you may need to obtain funding from another source such as a loan from family, friends or a bank.

Some start-up costs are easily identified, such as premises, equipment and materials. However, others are easy to forget. These will vary depending on the nature of your business. Typically, a new business may incur costs such as:

- **Premises:** If you are operating your business away from home you are likely to need some form of premises. This may be a retail outlet, warehouse, workshop or industrial unit. Whether you are renting, leasing or buying the premises you will incur some initial costs, plus ongoing costs of rent or mortgage payments.
- **Equipment and resources:** This may include furniture, office supplies, shop fit-out and machinery. You will need to consider whether you are going to purchase these items outright or on a lease agreement, and whether you buy new items or second-hand. You will also need to buy computer equipment and software to run the administrative side of your business, including accounts.
- **Vehicles:** You may need a car or van for business purposes. As for premises, there will be an initial cost, plus ongoing running costs of vehicles such as fuel, insurance, maintenance and road tax.
- **Materials:** You will need sufficient starting stocks of raw materials to start making your product or finished products to deliver to customers. You need to judge this carefully. Too much stock will mean cash tied up and unavailable for use for other commitments. Too little stock may cause delays in meeting your customers' demands.
- **Working capital:** You will need sufficient money available in your bank to cover the cost of expenses until income is generated from your sales.
- **Marketing:** Whether you choose traditional methods, such as advertisements, leaflets, brochures, etc., or online methods such as a website, you will incur costs for promotional materials to get your product or service known.

Other start-up costs that are often overlooked include:

- legal, accounting and consultancy fees
- connection fees to utilities
- licences, registrations and permits
- insurance.

In addition, you should set some money aside for contingencies and unforeseeable expenses.

CASE STUDY

Start-up costs

Victoria is setting up as a mobile hairdresser. She has estimated her start-up needs and costs as follows:

	\$
Vehicle purchase	2000
Annual vehicle insurance	250
Registration and tax for vehicle	220
Equipment – hairdryer, scissors, bowls, curlers, crimpers, etc.	500
Stock – shampoos, conditioners, hair colourants, etc.	210
Promotion – leaflets, business cards and posters	180
Public liability insurance	150
Working capital	100



OVER TO YOU

Activity 1

Calculate the business start-up costs for Victoria in the above case study. Enter the total start-up costs here:

Start-up costs (continued)

Victoria has \$2800 in a savings account which she intends to use to get her business started and has opened a business bank account with \$50.

Using the following table, calculate whether she has more than sufficient funds (surplus) for the business start-up, or whether she will need to obtain finance from another source (i.e. she has a deficit).

Business start-up cost	\$
Opening bank balance	\$
Total	\$
Personal savings available	\$
Surplus/deficit	\$

Financing a business start-up

There are a number of ways you can finance a business start-up which we'll look at below. You will need to make sure that you can access this money when you want it, without incurring additional bank charges for early withdrawal.

- **Personal savings:** Many self-employed people use savings to fund their business start-up. In some cases savings may have come from redundancy or severance payments from previous employment.
- **Overdraft:** This is a credit facility agreed with your bank which allows you to spend (temporarily) more money than you have in your bank account to cover short-term financing needs. You need to agree the overdraft limit with your bank, along with the terms and conditions. You will usually be charged interest on the amount outstanding at any time. You may also be required to pay an arrangement fee. It is quick to arrange, but the bank may withdraw the facility at any time and request that funds are paid into the account. You will only be able to get an overdraft from the bank where you hold your business current account.
- **Credit card:** This is a facility that is used to make purchases now that are paid for later. Credit cards are issued by banks and are a form of borrowing from the bank. At the end of each month you will be sent a statement showing how much you have borrowed. Lenders permit borrowers to make a partial monthly payment (anything between its minimum allowed amount and the full balance) or pay off the amount owed in full. If you do not pay the full amount, interest will be charged on the balance, often at a much higher rate than for other forms of borrowing.
- **Business loans:** These may be available for self-employed people. However, they will be agreed based on the individual's credit history rather than on the business accounts. The bank will want to see a realistic forecast of income and expenditure, as well as proof that you will be able to pay the loan back with interest. The amount of interest payable will often depend on how much you borrow and for how long. It will also depend on the interest rate offered by the lender, some of which can be quite high. Depending on the amount borrowed, the bank might require you to secure the loan with a "charge" on an asset such as a house or car, which means that they can take possession of this asset if you fail to repay.
- **Family and friends:** Many small businesses and self-employed people borrow money from family and friends rather than borrowing from banks. Whilst friends and family may be very willing to support your business with finance, you should treat any such loan with the same commitment to repayment as if borrowing from a bank. Failure to do so may impact negatively on your future relationships with them.
- **Grants and government backed lending schemes:** There are often thousands of grants available at any one time, some of which are provided by organisations; others may be backed by the government. Each grant scheme has its own set of eligibility criteria, most of which focus on the location, size and type of the business. It is worth checking the eligibility clauses for any particular grant before spending time putting an application together. The application process for grants can be lengthy and you will have to demonstrate how the money you receive will help the awarding organisation to meet their objectives. You may be expected to "match fund" the grant that you receive, so you need to make sure that you have this money available before making any application.

 OVER TO YOU

Activity 2

Consider how you might finance your business proposition.
Find out the cost and terms of business borrowing from banks in your local area.
Research any grants that might be available to you.

1.2 Produce a personal success and survival plan/ budget for individual circumstances

Setting the price of goods and services

Many business start-ups fail because there is insufficient demand for their product or service at the asking price. Therefore, it is very important to set a price that will cover all your costs and provide a profit, whilst remaining attractive to the customer. It is worth spending some time researching what your competitors charge for a similar product or service because if your price is much higher, customers will not buy from you.

You may have to think about not just one price, but several, particularly if you are selling through a number of different methods of operation. If you do not sell direct to the final consumer, then you have to take into account the fact that there may be additional costs that may be added to your selling price by distributors or retailers before the final consumer sees a price. The first step in determining your pricing structure is to understand your costs. These can be categorised as:

- **Fixed costs:** These costs stay the same regardless of how much you make or sell. They include costs such as rent, rates and insurance payments. As a result, they are relatively easy to plan for as they are usually agreed for at least a twelve-month period.
 - **Variable costs:** These are generally directly related to the level of production. Variable costs will include the cost of utilities such as gas, electricity, water etc., and also the cost of the materials used in production.
- Generally as production increases, these costs will increase. As a result they are harder to predict and plan for.
- Other costs may have elements of both fixed and variable costs. These are known as **semi-variable costs**. For example, the cost of telephones within the business will have fixed elements in terms of the rental of equipment, and variable costs in terms of the volume of calls made.

 NEED TO KNOW

Categorising costs as either fixed or variable helps a business owner understand the effect of changes in the level of business activity, and is a good basis for setting prices that will deliver the desired profit.



 **OVER TO YOU**

Activity 3

Classify the following business costs of a café.

	Fixed	Variable
Premises rental		
Coffee machine hire		
Coffee beans		
Cleaning materials		
Water		
Contents insurance		

Profit

Profits enable businesses to grow and even develop new products and services, or to enter new markets. Making a loss, however, may lead to a reduction in the business activities and its eventual failure. Profit is the amount of money left after fixed and variable costs are deducted from total sales.

 **NEED TO KNOW**

Profit = **Sales** - **Costs**



If business costs are greater than sales, the business will be making a loss.

There are two measures of profit. Both are calculated by subtracting costs from income:

- **Gross profit:** Relates to the money left over after the “cost of sales” (the total costs directly attributable to making or providing the product/service) are deducted from income or sales. These include material costs for producing the item (like ingredients for bread, for a baker) or the cost of the item when bought as stock (toys bought to sell in a toy shop, for example).
- **Net profit:** Relates to the money left over after all costs, including the cost of making or providing the product/service, fixed costs such as rent, rates etc., and variable costs such as gas, electricity are deducted from income or sales.



The relationship between gross profit and net profit is demonstrated below:

	\$
Income	95000
Less cost of sales	35000
Gross profit	60000
Less other fixed and variable costs	40000
Net profit	20000

Break-even

Understanding and categorising fixed and variable costs is useful in determining the **break-even point** for a business. This is best described as the point at which costs and sales income are equal. In other words, the business is achieving neither a profit nor a loss.

A break-even analysis shows the sales volume that is necessary to cover all the costs of the business. It is particularly useful if the products or services sold have costs directly associated with them, such as the costs of buying materials to make the products. This is because every product that is sold generates an additional cost. Therefore, the more that is sold, the higher the costs will be.

Number of units	Total costs	Sales income	Profit/loss
0	10000	0	-10000
100	13000	5500	-7500
200	16000	11000	-5000
300	19000	16500	-2500
400	22000	22000	0
500	25000	27500	2500
600	28000	33000	5000
700	31000	38500	7500
800	34000	44000	10000
900	37000	49500	12500
1000	40000	55000	15000

Break-even point

Table 1: Break-even analysis



Managing income and expenditure

Forecasting

Forecasting requires a business owner to make assumptions about future levels of income and expenditure (costs) to determine the flow of cash into and out of the business. Effective forecasting helps business owners to monitor their income and to anticipate and control expenditure. It may also be required by a bank if you wish to take out a loan or use an overdraft facility.

A cash flow forecast will show the predicted flow of money into and out of the business over a period of time. As well as showing the predicted level of sales or output by month, it will also show all the expenditure, both fixed and variable costs, recorded against the months in which the payments are expected to be made. The difference between the income and expenditure in one month indicates the amount of cash available to the business at any one time. This may vary from month to month as sales and expenses rise or fall.

Figure 1 shows an example of a cash flow forecast:

	Month 1	Month 2	Month 3
INCOME	\$	\$	\$
Hairdressing sales	2000	2000	2200
Beauty salon sales	1500	1600	1600
Product sales	400	400	400
Total income	3900	4000	4200
EXPENDITURE			
Electricity	600		
Heating		400	
Water	150	150	150
Premises rent	580	580	580
Stock	500	550	600
Loan repayment			2500
Wages	2000	2000	2000
Total expenditure	3830	3680	5830
Net cash flow	70	320	-1630
Opening bank balance	1000	1070	1390
Closing bank balance	1070	1390	-240

Figure 1: Cash flow forecast



Having entered all the anticipated income and expenditure in the appropriate month, the total expenditure is deducted from the total income for each month. The net cash flow is added to the opening balance (the amount of money in the bank account at the start of the month) to determine the closing balance (the amount of money in the bank account at the end of

the month). The closing balance in one month becomes the opening balance in the next month and is carried forward to the next column.

To illustrate this let's look at the figures in month 1. The total income is \$3900 and the total expenditure is \$3830. That means that the business has taken \$70 more in sales than its expenditure in that month (the net cash flow). The net cash flow is added to the amount of money in the bank at the start of the month (the opening balance) resulting in an end of month balance (closing balance) of \$1,070 which is carried over to the opening balance in month 2.

As the months go by, it is advisable to update the forecast by adding detail about the actual income and expenditure. This is illustrated in Figure 2. The "Actual" is completed once the business is operating and actual income and costs can be recorded. You can see there is some difference in the forecasted figures when compared with the actual figures.

In the following example, the actual sales in month 1 were less than anticipated resulting in a negative net cash flow at the end of the month, which in turn reduced the bank balance at the end of the month.

	Month 1		Month 2		Month 3	
INCOME	Expected	Actual	Expected	Actual	Expected	Actual
Hairdressing sales	2000	1500	2000		2200	
Beauty salon sales	1500	1250	1600		1600	
Product sales	400	250	400		400	
Total income	3900	3000	4000		4200	
EXPENDITURE						
Electricity	600	600				
Heating			400			
Water	150	150	150		150	
Premises rent	580	580	580		580	
Stock	500	350	550		600	
Loan repayment					2500	
Wages	2000	1500	2000		2000	
Total expenditure	3830	3180	3680		5830	
Net cash flow	70	-180	320		-1630	
Opening balance	1000	1000	1070	820	1390	
Closing balance	1070	820	1390		-240	

Figure 2: Actual income and expenditure



Controlling costs

Forecasting enables business owners to clearly see periods when income may not be sufficient to cover costs and enables them to prepare for such eventualities. This might mean negotiating an overdraft with the bank to cover expenses so that liabilities can be met.

Approaches to controlling costs include:

- spreading costs evenly throughout the year;
- monitoring actual costs against forecasted costs on a monthly basis;
- regularly reviewing costs and eliminating those that do not contribute to the business success;
- negotiating favourable terms and conditions with suppliers;
- monitoring over-ordering and waste.

 **OVER TO YOU**

Activity 4

Think about some of the costs associated with your business proposition. Then, using the template below, prepare a simple cash flow forecast for the first three months.

	Month 1	Month 2	Month 3
INCOME			
Total income			
EXPENDITURE			
Total expenditure			
Net cash flow			
Opening bank balance			
Closing bank balance			



Personal survival plan/budget

Income has to cover not only the costs of providing business products or services, but will also have to generate sufficient funds to support the personal financial needs of the business owner. Such needs would be the business owner's personal rent or mortgage, food, utilities, and day-to-day living expenses. These cannot be considered as a business expense. Calculating how much money is needed for personal survival, either weekly or monthly, will help a business owner decide whether a business idea is going to provide sufficiently for personal needs.

In the example shown in Figure 3, the business will need to provide the business owner with an income of \$3770 per year to cover personal expenditure in addition to the amount required to cover the business costs.

Estimated personal expenditure per year		\$
Mortgage/rent		6000
Local tax, water rates		1200
Gas, electricity, oil		1000
All personal and property insurance		250
Food, general housekeeping expenses		3600
Clothing		1000
Telephone and/or mobile		400
Internet		240
Entertainment (meals, drinks, etc) and annual holiday		500
Car tax and insurance		400
Car running expenses (including fuel)		120
Car service and maintenance		60
Children's expenditure and presents		500
Savings plans		500
Expenditure in the year	Subtotal (a)	15770
Estimated non-business income		
Income earned by spouse or partner		12000
Other income (please state) e.g. part-time job		
Total non business annual income	Subtotal (b)	12000
Total survival income required in the year from the business i.e. subtotal (a) less subtotal (b)		3770

Figure 3: Personal budget



The money taken from a business to cover these costs is known as **drawings**. Drawings are sums of money the owner receives during the course of the year in anticipation of the profits the business will make. As a result, planned drawings from the business for the owner's personal use should be included as an expense in the cash flow forecast.



OVER TO YOU

Activity 5

Make a list of your personal expenditure here.

Chapter 4

Business Finance and Recordkeeping

Introduction

Many self-employed people use the services of external experts, such as accountants, to produce end-of-year accounts to meet their legal obligations. However, it is essential when you are self-employed to keep accurate records throughout the year to provide these experts with the information they need in addition to maintaining their own financial controls. This chapter looks at the appropriate use of accounting source documents and shows how they may be recorded in a simple bookkeeping system, applicable in the context of local accounting ethical and taxation practice.

Learning outcomes

On completing the chapter, you will be able to:

- 1 Understand the requirements for accurate financial recordkeeping**
- 2 Demonstrate an awareness of the financial obligations of self-employment in the local environment**

Assessment criteria

- 1 Understand the requirements of accurate financial recordkeeping**
 - 1.1 Develop a recordkeeping process indicating relevant accounting source documents for a business proposition, taking into account local accounting practice
- 2 Demonstrate an awareness of the financial obligations of self-employment in the local environment**
 - 2.1 Outline the legal and financial obligations of self-employment in the local environment

ABE Level 2 Award in Setting Up Your Own Business

1.1 The requirements of accurate financial recordkeeping

The purpose of recordkeeping

Maintaining accurate records of financial transactions is essential for all businesses regardless of size. Keeping good records will:

- help you meet your legal obligations as a self-employed person;
- make sure that all expenses are taken into consideration when making an assessment of **personal tax liabilities**;
- ensure that all income and expenditure is recorded when calculating profit or loss;
- help you to control costs and reduce unnecessary expenditure;
- aid business planning through a greater understanding of the business strengths and weaknesses;
- provide useful evidence of business viability when seeking loans or grants.

Accounting source documents

Most day-to-day financial transactions result in the creation of a document that records the transaction. These **accounting source documents** are the evidence for your accounting system.

Small businesses that deal primarily in cash sales, such as retail, hairdressing, and catering, may record sales through cash registers using the **till roll** as a record of sales made and issuing receipts to customers. The till roll is used:

- to check that the money in the cash register is correct;
- as a record for the accounts.

Other businesses that deal with purchases/sales on a credit basis may use other business documents as the basis of their accounting system. The most common types of business documentation are listed below:

- **Estimates**: These are used where the exact price cannot be calculated. It is therefore an educated guess of the cost of a job. An estimate is not binding and may change once the true costs are known.
- **Quotations or "quotes"**: These are fixed price offers for doing a job that, once accepted by the customer, cannot be changed.

CASE STUDY

Preparing a quotation

Adam works as a self-employed decorator. Before commencing any job he provides his customers with a quote detailing the cost of materials and labour.

He has assessed a job and believes that the work will take four days to complete at \$80 per day.

In addition he will require the following materials:

- Paint – 10 litres @ \$25 per 5-litre can
- Sandpaper – 3 packs @ \$9
- Brushes – 2 @ \$12
- Dust sheet – \$14



OVER TO YOU

Activity 1

Prepare a quote for Adam using the information in the case study.

- **Delivery notes:** These are sent by the supplier to the customer to accompany a goods delivery. The customer can check this note against the order and actual goods received to ensure the delivery is correct.
- **Invoices:** These are sent by the supplier to the customer to request payment. The supplier will record these in their accounting system as a **Sales Invoice**. The customer receiving the invoice will record these as a **Purchase Invoice** in their accounting system.

A completed invoice for supply of goods might look as follows:

INVOICE			
Invoice number:	JAI0002	Date:	5 January 20XX
Supplied by:	TaiShoo Welsley Road Sometown SS9 4BZ	Supplied to:	Jaipura Northdown Road Anytown AT4 5FF
Quantity	Description	Unit price	Total amount
5 pairs	Ladies shoes, L45, size 6	20.00 per pair	100.00
4 pairs	Gents shoes, G98, size 9	30.00 per pair	120.00
			220.00
Terms: 30 days from invoice date		Less trade discount at 40%	88.00
Payment transfer to: High Street Bank Sort code 03-05-01 Account number 9878524		Subtotal	132.00
		Sales tax @ 20%	26.40
		Invoice total	158.40

- **Receipts:** These are sent by the supplier to the customer as confirmation that the payment has been received.

The simple flow of these business documents between customer and supplier can be illustrated as follows:

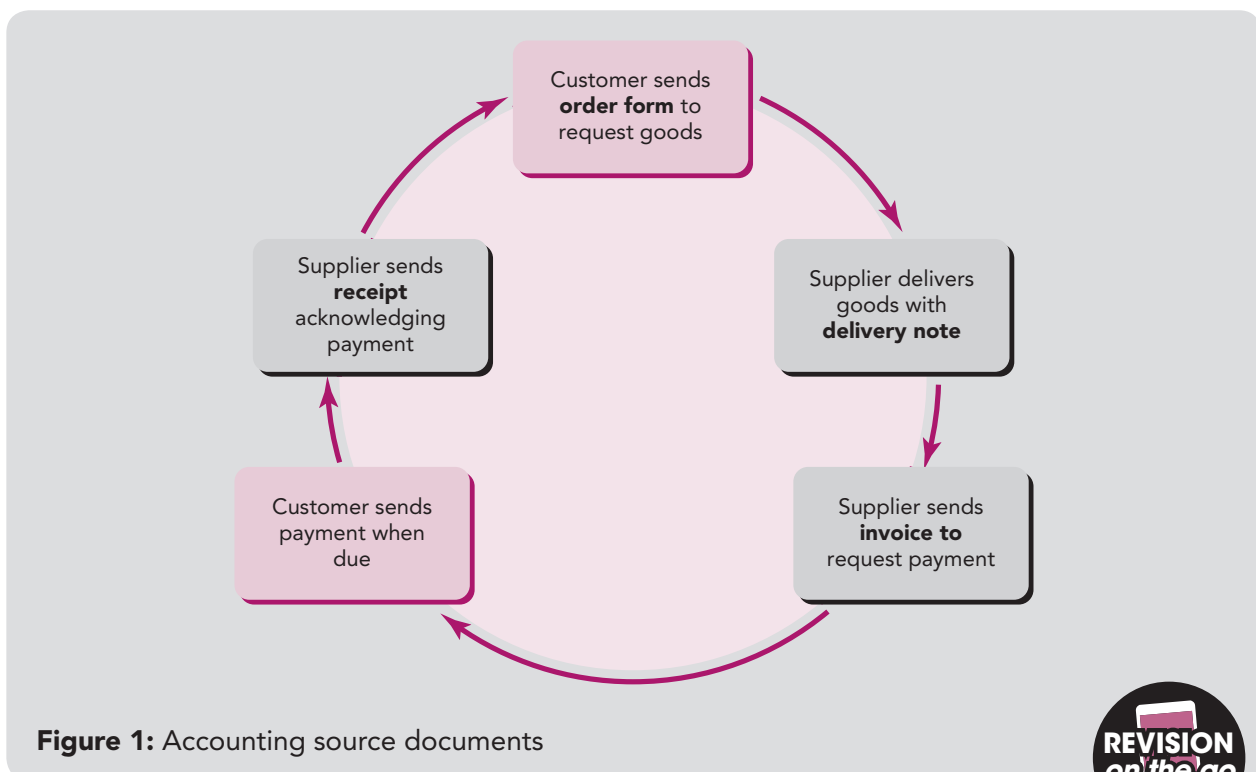


Figure 1: Accounting source documents



- **Credit notes:** These are issued by the supplier on the return of goods from a customer. This may be because the goods are faulty or not as requested. Credit notes are offset against outstanding invoices to reduce the amount owing.
- **Remittance advice:** These notes are sent to the supplier with the actual payment, e.g. cheque, or as notification of payment via bank transfer.
- **Statements:** These are issued by the supplier periodically, usually monthly, to the customer. It details the transactions between the supplier and customer in that period and therefore lists invoices, payments received and credit notes.

Which of these documents a business chooses to use depends on the size and nature of the business.

Other financial transactions that should be recorded include:

- **Petty cash:** This is the name given to the small amount of cash kept on hand for making minor purchases that do not warrant writing a cheque or making a bank transfer. When money is used from the petty cash fund it is replaced with a petty cash voucher indicating the amount taken. The total of the vouchers added to the remaining cash should always equal the agreed petty cash fund amount.
- **Expenses:** General expenses such as rent, utilities, telephone, etc. should be recorded in your recordkeeping system. Whether you pay these monthly by direct debit or on receipt of a bill, you must keep evidence of the payment and when it was made. Bank transactions such as direct debits, standing orders and bank transfer will be shown on your bank statement.

Basic single-entry bookkeeping

In the early days of a small business, it may not be necessary to keep a full set of accounting books and ledgers. Unless you are confident in your own accounting skills, it is likely that you will engage an accountant to prepare the final accounts on your behalf. However, you should make sure that you keep the documents identified above to enable an accountant to do this.

You should choose a bookkeeping system that is right for you so that you record your financial transactions as soon as you start your business.

A simple bookkeeping system may consist of:

- a weekly record of your financial transactions including receipts and payments and a summary of these weekly transactions;
- a file for keeping documents such as invoices and receipts together until you have time to enter them into your recordkeeping system so that you don't lose them;
- a file for keeping all transaction documentation that has been entered into your recordkeeping system;
- a storage box to keep all your records together as the year goes by and to archive them at the end of the year.

A **single-entry bookkeeping** system is an easy way of recording each income or expenditure. It may be completed manually, on a spreadsheet, or through customised bookkeeping software. It is particularly useful for small businesses that have few financial transactions.

! NEED TO KNOW

There are a number of websites that provide free, downloadable spreadsheets for small businesses to use such as:

<http://www.beginner-bookkeeping.com/single-entry-bookkeeping.html>

<https://www.smartsheet.com/top-excel-accounting-templates>



A single-entry bookkeeping system will record:

- **Sales receipts:** A record of the cash, cheques, credit-card payments and electronic payments via debit cards received each day, and the total at the end of the week.
- **Other receipts:** A record of other money that is received from non-trading activity such as tax refund.

An example of how you might record income and receipts is shown below:

Total income and receipts					
Day	Date	Cash	Cheques, credit and debit cards	Other receipts	Particulars of other receipts
Mon	02-Jan	186.27	45.78	10,000.00	Loan arranged
Tues	03-Jan	232.44		250.00	Tax refund
Wed	04-Jan	256.26	12.89		
Thurs	05-Jan	112.27			
Fri	06-Jan	290.54	70.50		
Sat	07-Jan	378.56	25.44		
Sun	08-Jan	390.99	145.20		
	Subtotals	1847.33	299.81	10,250.00	
Gross weekly takings		2147.14			

- **Money paid into the bank:** In the form of cash, cheques, credit and debit card transactions received each day, and the total at the end of the week.

An example of recording money paid into the bank is shown on the right:

Paid into bank				
Date	Cash	Cheques	Credit and debit cards	Total
02-Jan				
03-Jan		45.78		45.78
04-Jan	600.00			600.00
05-Jan				
06-Jan				
07-Jan	300.00	108.83		408.83
08-Jan				
Total	900.00	154.61		1054.61

- **Payments you make for business stock:** List the items that you have bought for resale and record from whom you have bought them. You should record whether you have paid for the item(s) by cash or cheque and total all payments at the end of the week.

An example of how you might record payments made for business stock is shown on the right:

- **Payments you make for items other than stock:** This includes postage, cleaning, rent, etc. Record whether the payment has been made by cash, cheque, credit or debit card and add them up to show a total for the week.

WEEKLY EXPENDITURE			
Payments for business stock			
Date	Supplier	Cash	Cheques, credit and debit cards
02-Jan	Contee & sons	850.00	
03-Jan	P & R Supplies	250.00	
06-Jan	JJ Fabrics	64.52	
06-Jan	M Lomax		120.89
	Subtotal	1164.52	120.89
	Total payments		1285.41

An example of how you might record payments made for items other than stock is shown below:

Payments other than stock		
Nature of payment	Cash	Cheque, credit card and debit cards
Wages	85.00	
Advertising	25.00	
Rent		400.00
Telephone		
Utilities		22.60
Entertainment	15.00	
Travel	25.00	
Postage	13.77	
Stationery	6.30	
Fuel		16.80
Drawings	6.50	
TOTAL EXPENSES	176.57	439.40

Manual cash book

A **cashbook** records all the money transactions into and out of the business. It therefore records:

- **Cash transactions:** All receipts in cash and most payments made in cash except for very small amounts which may be handled via a **petty cash book** if available.
- **Bank transactions:** All receipts by cheque, credit or debit card, or payments of cash into the bank, and all payments made by cheque or withdrawal of cash from the bank.

A simple cashbook layout is shown below.

Cash book									
Date	Description	Ref	Cash		Cash in hand	Bank		Bank balance	R
			Income	Expenditure		Income	Expenditure		
01-Jul	Balance brought forward (b/f)	1			250.00			480.60	R
03-Jul	P Landlord - Rent	2					400.00	80.60	R
04-Jul	Cash sales	3	92.00		342.00				
06-Jul	Sales - S van Zyl	4				82.50		163.10	R
06-Jul	Sales - P Erickson	5				54.00		217.10	R
12-Jul	Stamps and postage	6		8.00	334.00				
15-Jul	Gas Co	7					22.60	194.50	R
22-Jul	Fuel	8					16.80	177.70	R
23-Jul	Drawings	9					6.50	171.20	R
26-Jul	Office Furniture Ltd	10					85.00	86.20	
37-Jul	Cash sales	11	48.60		382.60				
30-Jul	Sales - R Oweena	12				179.80		266.00	
30-Jul	Bank fees	13					10.00	256.00	R
	Totals		140.60	8.00	382.60	316.30	540.90	256.00	

Regular checks should be made to make sure that records are being kept accurately and that the amount of money expected as cash in hand and in the bank are correct. Checking the cash columns is simply a matter of counting the money in the cash box or cash register and agreeing it with the amount shown as “cash in hand” in the cash book. Checking the bank columns requires some adjustments as there may be a delay in money arriving and leaving your bank, when cheques, credit and debit cards are used in transactions.

Bank reconciliation

The bank may send you a statement each month listing the activity in your bank account for that month, as well as the opening and closing balances on your account. Alternatively you may be able to access this information through internet banking so you will not have to wait for a statement to arrive.

It is important to verify that the amounts and transactions shown on your bank statement are the same as those shown in your own records. This process is called **bank reconciliation** and will identify any fraudulent activity, unauthorised cash transactions or incorrect recording in your bookkeeping system.

On receipt of your bank statement you should:

- 1 Check off with a ✓ or R each cashbook entry that has a matching bank statement entry.
- 2 Highlight any transactions that are unmatched. These may be:
 - Cheques or withdrawals that you have made and entered onto the cashbook but that have not yet been banked by a third party. These amounts should be added to the reconciliation.
 - Payments that you have received and recorded in your cashbook but which were not deposited into your bank account before the statement end date. These should be deducted from your reconciliation.
 - Bank fees or interest which you may only be aware of on receipt of your bank statement. These should be entered into the cash book.
 - Any other unidentified items which should be investigated and necessary adjustments made.

Bank Reconciliation Statement					
Business Name:		AA Business			
Date of Bank Statement:		July 31st			
Bank Account:		Current account			
Outstanding withdrawals			Outstanding deposits		
Date	Detail	Amount	Date	Detail	Amount
26/7	Ref 10	85.00	30/7	Ref 12	179.80
Reconciliation					
Closing cash book balance		480.60			
Add: Outstanding withdrawals		85.00			
		Subtotal	565.60		
Less: Outstanding deposits		179.80			
Expected bank statement balance		385.80			

In the example above, the bank statement should show an end of month balance of £385.80

CASE STUDY

The cashbook

Flora Galora is a small retail shop selling cut flowers and floral arrangements. The following transactions occurred in January.

1 Jan	Cheque payment – Old Street Petrol station	\$35.00
3 Jan	Cash withdrawal ATM – Green Bank ATM	\$20.00
6 Jan	Sale of floral arrangement Cheque no 44188	\$24.60
14 Jan	Cash sales deposited into the bank	\$80.00
18 Jan	Cheque payment – Old Street Petrol station	\$35.00
20 Jan	Sale of floral arrangement Cheque no 88214	\$24.99
20 Jan	Sales of cut flowers Cheque no 99485	\$17.50
21 Jan	Cheque payment to S&P Building Services (Building repairs)	\$50.00
25 Jan	Sale of wedding bouquet Cheque no 66621	\$16.20
28 Jan	Sale of table decorations Cheque no 66852	\$20.00
30 Jan	Sale of floral wreath Cheque no 99521	\$39.00
30 Jan	Cash withdrawal ATM – Green Bank	\$50.00



OVER TO YOU

Activity 2

Complete cashbook entries and a bank reconciliation for Flora Galora using the information given in the case study.

- 1 Enter the transactions listed in the case study into the following cashbook (bank column only)

Cash book						
Date	Description	Ref	Bank		Bank Balance	R
			Income	Expenditure		
1 Jan	Balance b/f	1			516.50	
Totals						

2 The following bank statement is received at the end of the month.

ABC BANK

Account Name: Flora Galora

Sort Code: 62-12-33

From 01 January 20xx to 01 February 20xx

Account number: 55243377

Your account:

Balance on 01 January 20xx: \$516.50

Money in: \$483.29

Money out: \$687.00

Balance on 01 February 20xx: **\$312.79**

Date	Description	Money out	Money in	Balance
	Balance brought forward			516.50
1 Jan	Cheque payment – Old Street Petrol station	35.00		481.50
	Direct debit – Tele2 Mobile phone bill	20.00		461.50
3 Jan	Cash withdrawal ATM – Green Bank ATM	20.00		441.50
6 Jan	Cheque no 44188		24.60	466.10
11 Jan	Bank transfer – OJ Motors		300.00	766.10
14 Jan	Standing order to J Jones – ref: Rent	500.00		266.10
	Cash deposits – sales		80.00	346.10
16 Jan	Direct debit – Secure Homes – Insurance	27.00		319.10
18 Jan	Cheque payment – Old Street Petrol station	35.00		284.10
20 Jan	Cheque no 88214		24.99	309.09
	Cheque no 99485		17.50	326.59
21 Jan	Cheque payment to S&P Building Services	50.00		276.59
25 Jan	Cheque no 66621		16.20	292.79
28 Jan	Cheque no 66852		20.00	312.79
	Balance carried forward			312.79

Update the cashbook and complete a bank reconciliation using the template below.

Bank Reconciliation Statement					
Business Name:					
Date of Bank Statement:					
Bank Account:					
Outstanding withdrawals			Outstanding deposits		
Date	Detail	Amount	Date	Detail	Amount
Reconciliation					
Closing cash book balance					
Add: Outstanding withdrawals					
					Subtotal
Less: Outstanding deposits					
Expected bank statement balance					

1.2 Legal and financial obligations of self-employment

All countries have legal, financial and tax frameworks supported by rules and regulations with which individuals and businesses must comply. It is important that you understand these rules and regulations in your country and ensure that you are maintaining sufficient financial information to meet their demands.

In general, it is your responsibility, as a self-employed person, to inform the government department responsible for tax collection that you are working as a self-employed person and that you will be personally responsible for any tax liability.

As a self-employed person you are obliged to:

- prepare accounts based on your accounting records – these may be prepared by you or an accountant;
- complete and submit a tax return for reporting business profits and losses and identifying any tax liability;
- pay your tax on time;
- keep accounting records for a specified period of time (usually seven years);
- notify the tax collection department if your self-employment status changes.





OVER TO YOU

Activity 3

Explore the specific rules and regulations for taxation collection and payment in your country and make a note of them here.

Glossary

Accounting source documents

Documents that record the nature of the transaction, when it took place and its value.

Bank reconciliation Verifying the amounts and transactions shown on your bank statement are the same as those shown in your own records.

Break-even point The point at which the volume of production (in units) achieves neither a profit nor loss.

Business proposition What you are offering (product or service), who to, for how much and how you are going to get it to your customers.

Cashbook Records all the money transactions into and out of the business.

Contractor A self-employed person who undertakes to supply materials, goods or services to someone else at a mutually agreed price within a specified time period.

Drawings Sums of money the owner withdraws during the year for own personal expenditure in anticipation of the profits the business will make.

Employer's liability insurance Provides cover in the event of claims by employees who are injured or become ill as a result of their employment.

Fixed costs Costs that stay the same regardless of the level of output or sales.

Forecasting Making assumptions about future levels of income and expenditure to determine the flow of cash in and out of the business.

Freelance A person who works independently for a number of people providing a service by the hour, day or project. Usually refers to an artistic or creative field.

Gross profit The money left over after the costs of making or providing the product/service are deducted from income or sales.

Homeworking A self-employed person carrying out their business from their own home.

Intangible products These products, usually known as services, are items that the customer cannot physically see, such as insurance cover, downloadable music, mobile apps or a haircut.

Market research Collecting and analysing data and information relating to the marketing and consumption of goods and services.

Method of operation How you are going to get your product or service to the customer.

Net profit Money left after all costs are deducted from income or sales.

Outsource Using professionals or experts to carry out certain aspects of your business such as accountancy, or website management.

Petty cash A small amount of cash kept on hand for making minor purchases that do not warrant writing a cheque or making a bank transfer.

Physical offering A product or service that satisfies a customer's needs.

Primary or field research Involves gathering information for the first time and usually for a specific purpose.

Professional indemnity insurance Protects the business and its owner if a client or customer makes a claim against them as a result of their actions, omissions or breaches of professional duty in the course of their business.

Public liability insurance Covers the business if a customer or member of the public suffers a loss or injury as a result of the business activities and if that person makes a claim for compensation.

Qualitative data Obtained through talking to people, either in one-to-one interviews or in small focus groups where individuals feel comfortable to express their opinions and views.

Quantitative data Produces statistical and numerical results that may show market information relating to the size of the market, trends and financial indicators.

Secondary or desk research Uses information and data that is already available.

Segment Grouping your customers in terms of their characteristics and behaviour so that a target market can be determined.

Self-employment Describes the employment status of someone who works but is not employed by an employer.

Semi-variable costs Costs that have both fixed and variable elements.

Single-entry bookkeeping A simple bookkeeping system where only one record is kept of amounts owed and amounts due.

Sole trader The simplest and most common form of legal business structure which refers to the single owner of a business.

SWOT An acronym for Strengths, Weaknesses, Opportunities and Threats that provides a framework with which you can assess your business idea and decide on your business direction.

Tangible products These are physical items that the customer can see, touch or smell, such as clothing, food, jewellery, mobile phones, etc.

Till roll A roll of paper recording all the separate amounts paid for goods in a retailer's cash register.

Unique Selling Proposition (USP) This is what makes a product or service different from its competitors.

Variable costs Costs that rise and fall in relation to the level of usage, output or sales.

Work/life balance Managing the demands of work around commitments to family and others.

Working capital Money used by the business in its day-to-day operations.