



# RUNNING A BUSINESS

## Introduction

Owning and operating your own small business can be challenging, rewarding and stimulating, as well as hard work. It requires a great deal of planning, an understanding of customers and their needs and constantly staying ahead of your competition. For those prepared to take the risk and who finally make it, the sense of achievement and satisfaction is well worth the effort.

**Question 1: Match the words from the word bank below to the corresponding definitions in the table:**

	<b>Key word</b>	<b>Definition:</b>
1.		a business owned and operated by one person
2.		a business owned and operated by 2–20 people
3.		something an entrepreneur can see as an avenue to success
4.		the income earned by a business
5.		someone who starts, operates and assumes the risk of a business venture in the hope of making a profit
6.		the rights from a manufacturer to distribute its products under its name
7.		the coordination of the human, physical, financial and information resources to achieve the goals of the business
8.		the group of customers to whom the business intends to sell its products
9.		a very small segment of the total market
10.		the costs incurred in running a business
11.		the value of the business to the owner(s)
12.		when the company has become a separate legal entity from its owners (shareholders)
13.		when a business owner is personally responsible for all the debts of his or her business
14.		the ability of a business to pay its debts on time
15.		the process of identifying and minimising the risks faced by a business
16.		the ability of a business to develop strategies that ensure it has an 'edge' over its competitors

17.		methods used by a business to inform, persuade and remind customers about its products
18.		items of value owned by a business
19.		population characteristics that affect customer spending and include age, ethnicity, gender, marital status, family size and income
20.		the debts owed by a business to others
21.		amount remaining when operating expenses are deducted from gross profit
22.		if the business cannot pay its debts, a shareholder generally loses only the money he or she invested in the business
23.		the monetary value of a business's reputation
24.		collecting and analysing information about customers and the business opportunities available
25.		amount remaining when the cost of goods sold is deducted from revenue
26.		An assessment of a business's strengths, weaknesses, opportunities and threats.

Word bank:

Franchise, Promotion, Sole trader, Niche market, Goodwill, Liabilities,

Risk management, Business opportunity, Unlimited liability, SWOT analysis,

Owner's equity, Limited liability, Assets, Partnership, Target market,

Market research, Expenses, Revenue, Gross profit/ loss, Entrepreneur,

Demographic factors, Incorporation, Competitive advantage,

Net profit/loss, Management, Liquidity

# BEING AN ENTREPRENEUR

Most of us have seen something advertised and thought, ‘that is just what I need’. Someone had the original idea for this product and went on to start, operate and assume the risk of a business venture — that someone is an entrepreneur. The motivating force behind them doing this is the hope of making a profit.

## Reason for being self-employed

The desire to be your own boss is a major reason for people starting their own business. They desire the freedom to choose when and where they work, with whom they work and whether to work from home.

The great attraction is the belief that they will have more control over their life. Of course, they are also motivated by the financial rewards they believe can be gained from establishing a business. The simplest but most significant question a prospective business owner must ask is: ‘why do I want to go into business?’ The business owner’s personality, skills and ambitions need to be analysed because the future success of the business rests largely with the owner. For this reason, people should carefully consider the advantages and disadvantages of being self-employed.

## Advantages and disadvantages of being self-employed

Advantages	Disadvantages
<ul style="list-style-type: none"><li>• Be your own boss — independence</li><li>• Possibility of making a profit</li><li>• Challenge, reward and satisfaction</li><li>• Increase personal wealth</li><li>• Contribute to society</li><li>• Develop own creative ideas</li><li>• Overcome unemployment</li><li>• Achieve a better lifestyle</li><li>• Employ family members</li><li>• Possible tax advantages</li></ul>	<ul style="list-style-type: none"><li>• Hard work and long hours</li><li>• Other ‘bosses’ — customers, suppliers, financiers</li><li>• Income may fluctuate and be uncertain</li><li>• Risk of failure</li><li>• Stress and worry</li><li>• High levels of responsibility</li><li>• Constantly solving problems</li><li>• Difficulty in selling the business</li></ul>

## Skills required and personal characteristics needed

Bill Gates, co-founder of Microsoft Corporation, is a classic example of an entrepreneur. While a teenager, he decided to take the risk of establishing his own business and launched Microsoft. Today Microsoft software is used to operate millions of computers worldwide.

However, entrepreneurial qualities are not confined to the world’s famous people. At a recent swimming carnival, Yolanda Zurack, a Year 10 student, arranged to take along an Esky filled with cold drinks. During the very hot day, she sold all the drinks and made a reasonable profit. Yolanda Zurack and Bill Gates are both entrepreneurs. They organised their business, undertook the necessary arrangements for it to operate, and were prepared to take a risk. The size of the profits may differ, but they possess identical entrepreneurial qualities:

courage, motivation, determination and energy. Flair and creativity are also essential for an entrepreneur. They allow the entrepreneur to create or seize new opportunities

for business or new goods and/or services. Finally, the most important quality for an entrepreneur is the ability to set objectives and have a vision for the business's future. Having achieved his or her objectives, the entrepreneur must set new objectives, continually adjusting to changing business, economic and customer markets.

### **Seeing and taking advantage of an opportunity**

Successful entrepreneurs are able to identify and take advantage of an opportunity. Identifying a **business opportunity** is not just about having an idea. An opportunity is something that a person can see as an avenue to success. It is often identified when a person feels they can provide goods or services in a better or different way from that already in the market, as it was the case with Kath Fry and Eisha Saleh's business Baraka Women.

Business owners should try to select a business opportunity that suits their personality and builds on their strengths. If you look around, you will see so many opportunities for starting a business. Potential business owners are always searching for opportunities, including ideas for new products, new customers and new ways of running businesses. There are many sources of opportunities for business ideas, including innovation and entrepreneurship, recognising and taking advantage of market opportunities, changing customer needs, research and development, technological development and global markets. Successful business managers and entrepreneurs will be very quick to seize their opportunities.

The source of a business idea may come from a person's own experiences, interests, abilities or imagination. Inspiration for ideas and opportunities can be generated by:

- listening to people, particularly for ideas on goods or services that may not be readily available
- reading magazines and books and researching on the internet
- visiting displays and exhibitions in areas such as new technology or new products from overseas
- accessing government statistics and research information
- identifying a 'gap in the market' — that is, a demand not currently being satisfied determining improvements that could be made to an existing product.

The successful identification of a gap in the market is key to establishing a lucrative business. It means that the new business provides something not already available. Breaking into a market that is already well served means that the new business has to do something exceptional to draw customers away from existing businesses.

### **Demonstrating initiative, innovation and resilience**

A successful entrepreneur demonstrates initiative, innovation and resilience. Initiative refers to the ability to be resourceful and decide, in an independent way, what to do and when to do it. When you show initiative, you do things without being told; you find out what you need to know; you spot and take advantage of opportunities; and, you keep going when things get tough. Initiative requires resilience and determination.

Running a business can be very stressful and unpredictable. Successful entrepreneurs, therefore, need to be resilient. Innovation is often what excites and motivates a businessperson to establish a business. **Innovation** generally refers to the process of creating a new or significantly improved product, service or process (way of doing something). An invention refers to the development of something that is totally new, but innovation and invention both result in the creation of something unique. Ideas for new products or improvements to existing products will often provide the opportunity for the establishment of a new business.



## QUESTIONS

**1. What is the role of an entrepreneur in our economic system?**

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**2. Discuss the advantages and disadvantages of being an entrepreneur.**

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**3. What is meant by a 'business opportunity'?**

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**4. Explain how failure can lead to success.**

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**5. Aside from the four entrepreneurial characteristics discussed in this chapter, identify some other personal characteristics and qualities that successful entrepreneurs possess.**

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**6. Think about a business you might one day like to own. What personal qualities and skills do you think are needed to be successful in this business?**

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**7. Create a table with two columns. In the first column, list the skills that you presently possess and could bring to a small business. In the second column, list other skills that you would need to develop.**

<b>Current Skills</b>	<b>Skills to Develop</b>

# INDIGENOUS AND TORRES STRAIT ISLANDER ENTREPRENEURS

## **CASE STUDY: Dion Devow – Indigenous entrepreneur**

Dion Devow established clothing label Darkies Design in 2010. The business produces contemporary Aboriginal-themed clothes and print media for mainstream, sports and promotional use. Dion identified a business opportunity after not being able to find Indigenous Australian clothing labels that suited him. The catalyst for Darkies Design was the realisation that there was a gap in the market for contemporary Indigenous Australian clothing. Dion chose the controversial name because he wanted to negate the derogatory term and express pride in his heritage and culture.



In addition to running Darkies Design, Dion Devow also works closely with other Indigenous people to help empower them to start their own businesses and achieve economic independence.

In 2015 he helped establish an Indigenous business owners network, the Canberra Business Yarning Circle, which assists Indigenous people to develop business skills and confidence. Through his experiences running multiple businesses, he wanted to create a forum that provides advice and support to many Indigenous people who have aspirations of entering into business. Since its inception, this organisation has helped establish and mentor many new Indigenous Businesses. Dion enjoys this work and feels a sense of satisfaction in being able to give back to the community.

Dion also began the Canberra Indigenous Entrepreneurs Centre whose vision is to create a supportive environment for the establishment and growth of small and medium Indigenous businesses. The motivation behind the establishment of this organisation as well as the Canberra Business Yarning Circle is due to his belief that business networking and developing relationships with others is one of the most important contributing factors to success.

Dion hopes to use the knowledge and experience he's obtained to be a positive example to others. He believes that all aspiring entrepreneurs should reach out and build relationships with other businesses either through mentoring, informal discussions, business associations or formal networking forums. 'Networking introduces you to people who may become key contacts for developing your business. You never know who you're going to meet and what opportunities will come from that. Building connections in your community often leads to positive word of mouth. If you make a good impression, you will find people who are always willing to help, offer advice or make a referral. No one achieves anything by themselves.'



Dion is a firm believer in undertaking market research as a way to mitigate the risks involved in running a business. He recommends that businesses starting out use economical methods such as social media. Whenever Dion has ideas for new designs, he puts up images on a variety of social media platforms to gauge people’s reaction. However, Dion warned that you need to be cautious of the response you receive as this type of feedback isn’t always foolproof. Just because people ‘like’ something, doesn’t mean they will buy it. For instance, a few years back Dion had an idea to create a yoga mat with Aboriginal prints. He got some samples made and posted them on social media where he was overwhelmed with positive responses. Based on this feedback he decided to invest in the creation of the mats, but they didn’t sell.

Dion believes it takes persistence, determination and courage to achieve success with any business venture. ‘It takes time to create a successful business and it’s not easy, but you have to believe in yourself and take a leap of faith. You need to be driven and have courage, as there are definitely a lot of risks involved. Setbacks are inevitable, but you should accept that failure is part of the process. If you are faced with a setback, don’t think of it as a total failure, but rather, think of it as a stepping-stone in your journey towards success. Running a business is very hard, but you need to persevere.’

In 2014, Dion’s business was named ACT NAIDOC Indigenous Business of the year and in 2016, he was named ACT NAIDOC Person of the Year. Two years later he was awarded the 2018 ACT Australian of the Year. Dion received this honour for his clothing enterprises and the work he has done supporting many Aboriginal people to achieve their dreams. Dion is humbled by these accolades and is hopeful that his achievements will inspire other Indigenous people.



## QUESTIONS

- 1. What business opportunity did Dion Devow identify that inspired him to establish Darkies Design?**

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**2. Outline the qualities and capabilities that Dion Devow believes contribute to business success.**

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**3. What characteristics does Dion possess that make him a successful entrepreneur?**

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**4. How will his success impact the indigenous and Torres strait islander community?**

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# PLANNING FOR SUCCESS

**Market research:** There will always be a risk involved in starting up a new business. Will the proposed new product or service attract customers? Will it appeal to enough customers and generate sufficient sales to cover costs and make a profit? Anyone thinking about commencing a business should first gather some ‘facts and figures’, especially to determine whether the level of demand for the new or improved product is sufficient to generate a profit.

The process of information gathering is known as market research. **Market research** involves collecting and analysing information about customers and the business opportunities available. Market research helps the entrepreneur to make better decisions by understanding consumer behaviour. By collecting and assessing information about the needs and wants of consumers, a more accurate and responsive marketing plan can be designed and, therefore, the risk of failure can be reduced. To obtain accurate information, marketers usually follow a three-step approach.

## ***The three steps of the market research process:***

Step	Explanation
1 Determining information needs	The problem is clearly and accurately stated to determine what needs to be measured and the issues involved. This is a crucial step.
2 Collecting data from primary and secondary sources	At this stage the researchers know the facts that are needed and those that are already available. Plans must be made to gather missing data. Information may be collected from primary data (facts and figures collected from original sources for the purpose of the specific research problem — for example, surveys and focus groups) or from secondary sources (facts and figures already collected by some other person or organisation — for example, research reports or census data).
3 Analysing and interpreting data	Facts by themselves do not always provide a solution to the marketing problem. They need to be analysed and interpreted to determine what they mean.

**Location:** *A good location will lead to more sales. A good location can make the difference between success and failure. This is particularly true for retail ‘bricks and mortar’ businesses, which generally need a constant flow of people walking past the store. A suitable location might be a shopping centre, mall or main street, or the business owner may choose an online presence or prefer a home-based business. This will depend on the nature of the business.*

Where to locate a business is a crucial decision because this will have an impact on profits. The location chosen can affect many aspects of how a business operates, such as total sales and how expensive it is to run. Most businesses will seek locations that maximise their revenue and minimise their costs. The factors that should be considered when selecting an appropriate location will be examined

**Demographics:** *It is important for an entrepreneur to understand the changes that are taking place in the make-up of the population. Demographic factors are population characteristics that affect customer spending and include age, ethnicity, gender, marital status, family size and income. An examination of a region's demographic pattern will provide a clearer picture of a business's possible customers.*

**Competition:** Both Coles and Woolworths are very similar in relation to the brands they offer, prices, layouts, weekly specials and online options. In 2011, Coles began what became known as the 'supermarket price wars' by reducing the price of their own-brand milk to A\$1 per litre. Woolworths hit back, triggering seven years of intense price competition. Now, rather than price, the two supermarkets have shifted their focus to service quality, social programs and connecting with the community in an effort to get an advantage.

**Competition** refers to rivalry among businesses that try to supply the needs and wants of a market. Competitors, therefore, are other businesses that offer rival products or services. Businesses need to be mindful of the actions and strategies implemented by their competitors as this can affect their sales. Not only do they need to be aware of existing competitors, but they also have to monitor the environment for potential newcomers. Managers need to ensure that they respond to any changes in the actions of their competitors.



Business owners should aim to achieve a **sustainable competitive advantage** over their competitors so they can capture a larger share of the market. A sustainable competitive advantage refers to the ability of a business to develop strategies that will ensure it has an 'edge' over its competitors for a long period of time.

**Target markets:** Many entrepreneurs are so enthusiastic about starting, they often overlook one crucial question: 'Who will buy my good or service?' Sales are the lifeblood of the business, so it is necessary to have a good understanding of one's target market.

**Target market** refers to the group of customers to whom the business intends to sell its products. Once the target market has been identified, the business concentrates its marketing activities on that group. For example, a sophisticated men's suit business in central Sydney might typically aim its marketing activities at a customer who is male, aged 30 to 50, city-based and earning an above-average income.

# QUESTIONS

**1. Why is it important for an entrepreneur to:**

**a. undertake market research:**

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**b. Identify their target market?**

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**2. Why should businesses aim to achieve a sustainable competitive advantage over their competitors?**

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**3. Identify different options for a business location, i.e. different places businesses can be located.**

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**4. Maintaining a competitive advantage is essential for long-term business success. What do you think a business can do to keep ahead of its competitors?**

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**5. Besides an ageing population, outline other demographic issues that currently impact on businesses in Australia.**

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**6. What factors should businesses consider when determining an appropriate location?**

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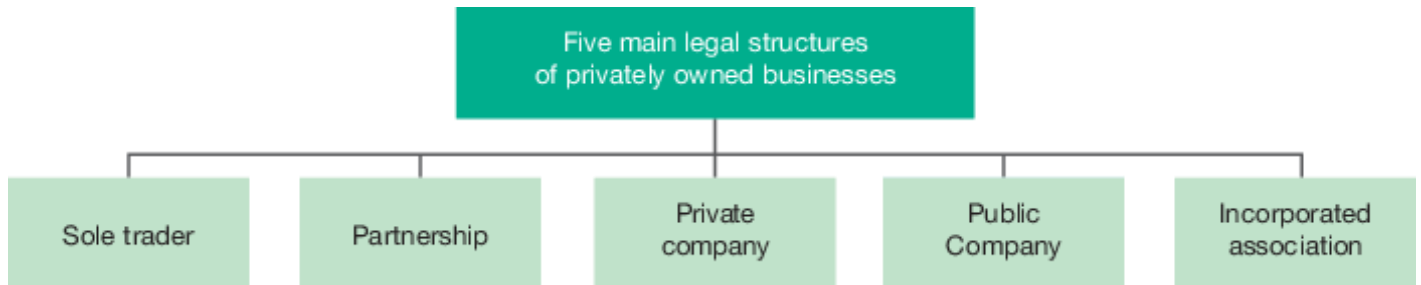
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# KEY FEATURES OF ORGANISATIONAL STRUCTURES

## Types of legal structure

There are a number of different legal ownership structures available to a person wishing to establish a business. Five main types of privately owned business entities are shown in the diagram — sole trader, partnership, private company, public company and incorporated association.



As can be seen by this diagram, these five entities can be divided into:

- unincorporated business entities, in the case of sole traders and partnerships
- incorporated business entities, in the case of private companies, public companies and incorporated associations.

The term **incorporated** refers to the process companies go through to become a separate legal entity from the owner/s. This means the business exists in its own right, its own legal entity. Regardless of what happens to individual owners (shareholders) of the company, the business continues to operate. The business has taken on a life of its own. Consequently, the company can sue and be sued, can own and sell property, and has perpetual succession – it will continue to exist even when the owners change.

An unincorporated business has no separate legal existence from its owner(s) and will be either a sole trader or partnership. This means the business entity and the owner(s) are one and the same. When the owner dies then so too does the business entity.

Selecting the appropriate business structure is another important decision a business owner has to make. Each of the different legal structures is covered by different government regulations that must be followed and, as such, have an enormous effect on the overall running of the business.

## Selecting appropriate structures

Legal structure	Characteristics
<b>Sole Trader</b>	<ul style="list-style-type: none"> <li>• A <b>sole trader</b> is a business that is owned and operated by one person.</li> <li>• It is the most common type of business in Australia. A sole trader is the simplest and cheapest structure to establish.</li> <li>• The sole trader receives all the profit and suffers all the losses.</li> <li>• He or she has <b>unlimited liability</b>. This means he or she can be forced to sell personal assets such as the house or car to pay for business debts.</li> </ul>
<b>Partnership</b>	<ul style="list-style-type: none"> <li>• A <b>partnership</b> is a business usually owned and operated by between two and 20 people, called partners.</li> <li>• The partners share their profits and losses.</li> <li>• It is common for people with similar skills, such as doctors and solicitors, to form a partnership.</li> <li>• Partnerships also have unlimited liability, meaning that all the owners are personally responsible for the business's debts.</li> </ul>
<b>Private company</b>	<ul style="list-style-type: none"> <li>• A <b>private company</b> usually has between two and 50 private owners called shareholders.</li> <li>• These businesses tend to be small to medium in size. Often, they are family-owned.</li> <li>• Shares in private companies are offered only to those people the business wants as part-owners. This is why it is called a 'private' company.</li> <li>• A private company must have the words 'Proprietary Limited', abbreviated to 'Pty Ltd', after its name.</li> <li>• The main advantage of a private company is that shareholders have <b>limited liability</b>.</li> <li>• This means that if the business cannot pay its debts, a shareholder generally loses only the money she or he has invested in the business.</li> </ul>
<b>Public company</b>	<ul style="list-style-type: none"> <li>• A public company can have an unlimited number of shareholders. The shares for public companies are listed on the Australian Securities Exchange (ASX), and the general public may buy and sell shares in those companies. Most public companies are large.</li> <li>• Shareholders in public companies have limited liability.</li> </ul>

	<ul style="list-style-type: none"> <li>• A public company must have the word 'Limited', abbreviated to 'Ltd', after its name.</li> </ul>
<b>Incorporated association</b>	<ul style="list-style-type: none"> <li>• A group of five or more people may form an incorporated association in New South Wales by registering with NSW Fair Trading.</li> <li>• Incorporated associations are small-scale, non-profit and non-commercial in nature. They can only conduct business in the state in which they are registered.</li> <li>• An incorporated association has its own legal identity separate from its members, which provides protection to members.</li> <li>• Small community groups such as sports clubs and art groups usually choose to register as incorporated associations.</li> <li>• The incorporated association structure can be more effective for these types of organisations as they are generally simpler and more affordable than a company structure.</li> </ul>

## QUESTIONS

1. Complete the following table to show how each of the following businesses is owned by writing the name of the business in the correct column. The first one has been completed for you.

Sole trader	Partnership	Private company
Isabella's beauty shop		

**Various businesses:** Isabella's beauty shop, Tom Wilson Plumbing, Tip Top Pty Ltd, Tyler and Kelly, M & M Communications, Becky's Pty Ltd

2. Decide what form of ownership structure is appropriate for each of the following businesses. Provide reasons for your answers.

a) A small bicycle shop:

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b) A medical clinic:

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c) A not-for-profit community centre:

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**3. Michael operates a pizza and pasta shop as a sole trader and he employs two cooks, one full time and one part time. He decides to offer the full-time cook a 40 per cent partnership in the business.**

A. What advantages will the owner gain from this arrangement that he does not have as a sole trader?

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B. What disadvantages could the owner experience from the partnership arrangement?

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C. Outline the advantages and disadvantages to the cook of entering into the partnership.

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D. Prepare a list of questions the cook should ask the owner before entering into the partnership agreement.

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# ESTABLISHING A NEW BUSINESS OR PURCHASING AN EXISTING BUSINESS

**There are three main ways of going into business:**

- setting up a new business
- purchasing an existing business
- purchasing a franchise.

Choosing between the three main options is sometimes quite difficult; each has advantages and disadvantages.

## 1. Setting up a new business:

Usually it is better to start a new business than purchase an existing one when:

- a person has created something unique and starts a business to market their invention
- an existing small business does not satisfy the needs of customers
- the market has grown and existing businesses cannot support additional customers.



Troy Bartlett, owner of Prema Press Tools Australia, and Kath Fry and Eisha Saleh, owners of Baraka, display the commitment needed to start a new business.

### **Advantages:**

Starting a business from scratch has a number of advantages:

- The owner has the freedom to set up the business exactly as he or she wishes.
- The owner's objectives can be matched more closely to the business.
- The owner is able to determine the pace of growth and change.
- The owner has more flexibility to select the location, target market, range of products and level of customer service.
- There is no goodwill for which the owner has to pay.
- If funds are limited, it is possible to begin on a smaller scale.

### **Disadvantages:**

However, there are also disadvantages:

- There is a high risk and a measure of uncertainty. Without a previous business reputation, it may prove difficult to secure finance.
- Time is needed to develop a customer base, employ staff and develop lines of credit from suppliers.
- If the start-up period is slow, then profits may not be generated for some time.
- Potential customers may be more difficult to attract than initially expected or unforeseen competition may appear, especially if the level of planning was inadequate.

## 2. Purchasing an existing business:

When an existing business is purchased, the business is already operating and everything associated with the business is included in the purchase — for example, stock and equipment, premises, existing customer base, staff, and reputation and goodwill. The owner of an existing business will always present the most positive picture when selling his or her business. It is important, therefore, to find out why the business is for sale. It may be a struggling business with complex problems rather than an exciting, once-in-a-lifetime opportunity. Before signing a contract of sale, the buyer should get financial and legal advice.



### Advantages

Buying an established business has a number of advantages:

- Sales to existing customers will generate instant income.
- A good business history increases the likelihood of business success.
- Stock has already been acquired and is ready for sale.
- Equipment is available for immediate use.
- Existing employees can provide valuable assistance.

### Disadvantages:

- The existing image of the business may be difficult to change, especially if the business had a poor reputation.
- The success of the business may have been due to the previous owner's personality and contacts and this may be lost when the business is sold.
- It may be difficult to assess the value of goodwill with the likelihood of paying more than the business is worth.
- Some employees may resent any change to the business operation.

## 3. Purchasing a franchise:

Under a franchise agreement a person (*franchisee*) buys the right to use the business name and distribute the goods or services of an existing business (*franchisor*). People choose to start a franchise in the hope of avoiding many of the problems associated with starting a new business. For a set fee, the small business owner receives the benefits of a successful business formula, a well-recognised name and established trademarks. Franchises are the fastest growing area of small business. There are approximately 1120 franchisors in Australia and 79 000 franchisees.



### Advantages:

- Products, equipment, premises design and marketing are usually established.
- The franchisor often provides training.

- There is less need for the franchisee to have previous business experience.
- The investment risk may be lower.
- There is immediate benefit from the franchisor's goodwill.

**Disadvantages:**

- The franchisor usually controls everything to do with price, suppliers and health regulations.
- Profits must be shared with the franchisor.
- The franchisor often charges a service fee for advice.
- Contracts may be biased in favour of the franchisor.
- The franchisee may merely feel like an employee, but without the benefits and security.
- The franchisee has to deal with day-to-day operations and they are legally accountable.



**1. One advantage of setting up a new business is not having to pay for goodwill. Explain this advantage.**

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**2. List three circumstances when it may be better to start a business from scratch than to purchase an existing one.**

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**3. Why should a buyer of a business consult an accountant and solicitor before signing a contract of sale?**

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**4. Distinguish between a 'franchisor' and a 'franchisee'. List two main benefits of each.**

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**5. Suggest why some people choose to buy an existing business rather than set up a new one.**

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**6. Why do you think businesses operating as a franchise have a success rate three times that of independent businesses?**

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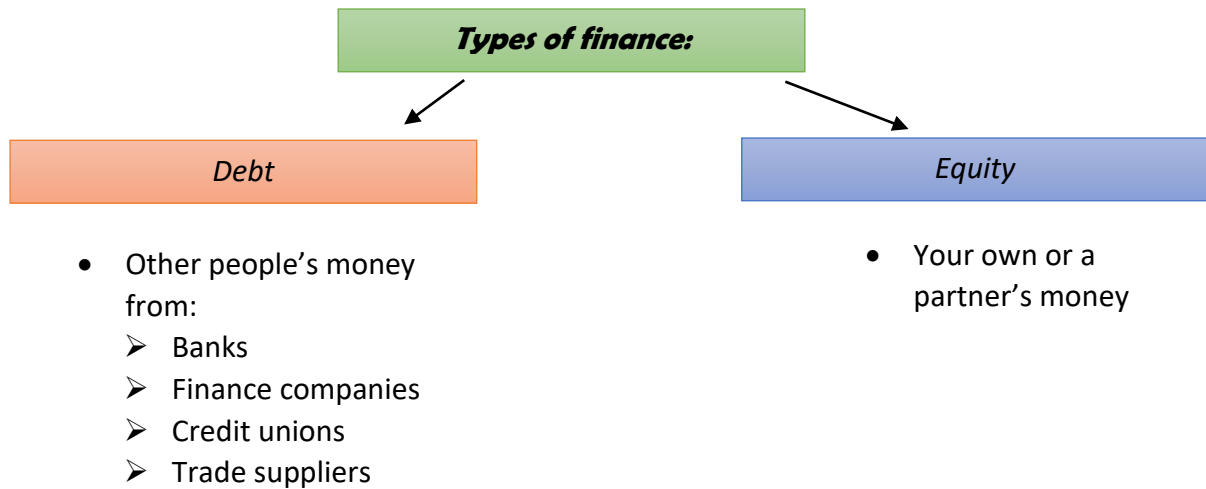
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## SUMMARY: 'ARRANGING FINANCE'

There are two main types of finance available to start and operate a small business.



Debt finance is money obtained through loans. Equity finance is money received from the sale of shares of ownership in the business. The main advantages with debt financing is that the owner does not have to sell any ownership in the business.

Also, debt financing has certain taxation advantages. For these two reasons, debt financing is the most popular source of finance used by businesspeople when starting a small business.

### Questions:

**1. Explain the difference between debt and equity finance?**

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**2. What are the advantages of debt finance?**

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## **THE PREPARATION OF A LOAN APPLICATION**

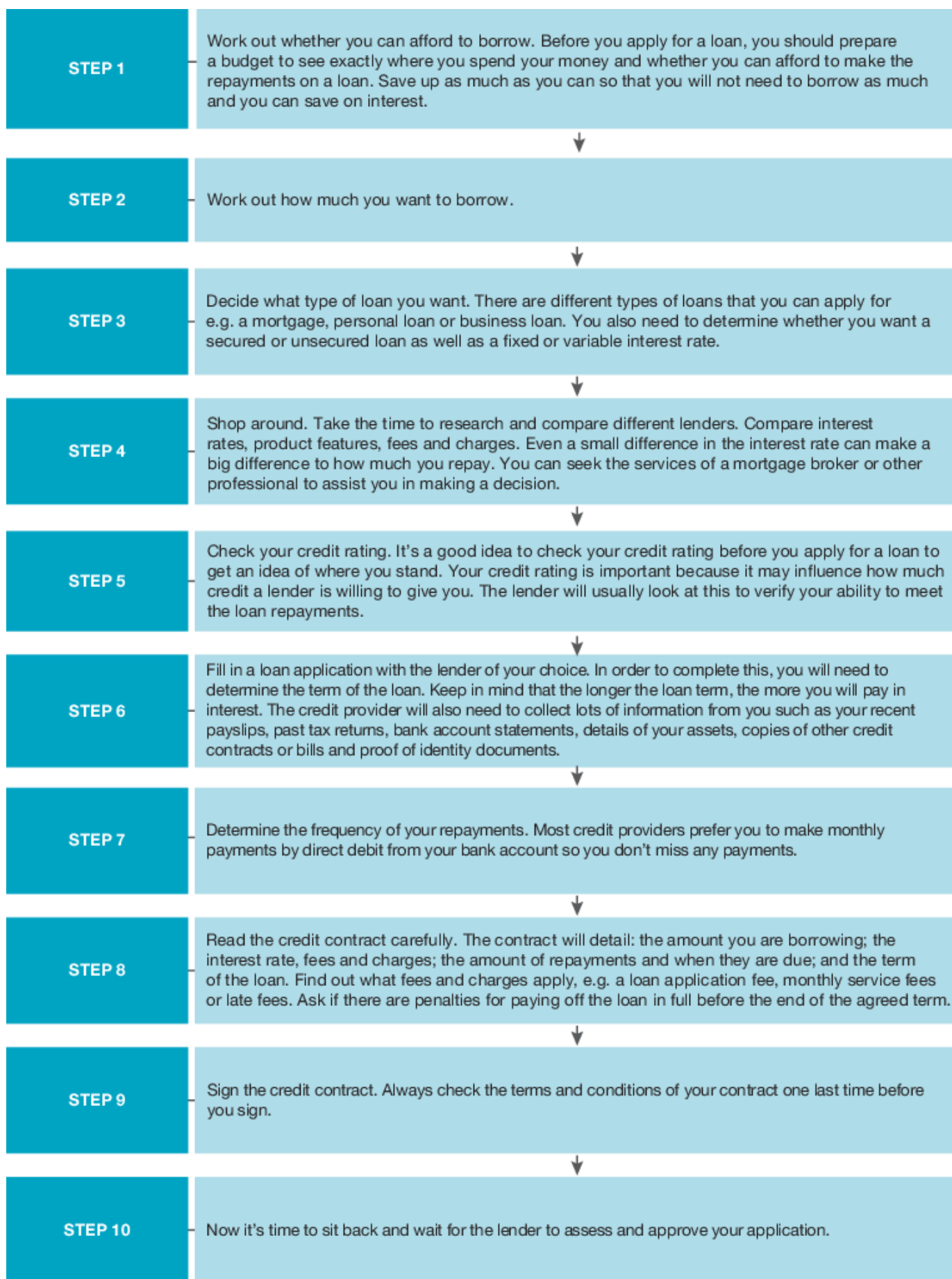
Sometime in the near future, you may consider taking out a loan to pay for something such as a holiday, car or even a house. Most people wishing to start a new business don't have the required funds so may need to obtain a loan.

Loans are typically used for specific purposes — e.g. for a car, house or to start a business. A loan is an agreement to borrow a set amount of money that needs to be repaid within a certain period of time. This is called 'the term'. The term of the loan can vary. Anyone that borrows money will need to pay interest on the amount they borrow. This interest may be at a fixed rate, where the interest rate is locked in for the term, or a variable rate, where the interest may go up or down over the term. While a fixed rate loan offers the benefit of set repayments, if you want to make extra payments from time to time, you will usually have to pay an additional fee.

A loan may be **secured** or **unsecured**. A **secured loan** is where the borrower offers an asset as security, such as a car or a house, for the loan. If they don't repay the loan, the lender may sell that asset to get their money back. Secured loans offer a lower interest rate but run the risk that the lender may have the right to sell the security if the borrower can't pay.

With an **unsecured loan**, the borrower does not need to have an asset to offer as security, but the interest rate is usually higher. A person wishing to get a loan will need to consider carefully which type of loan best suits their needs.

**The following are steps involved in preparing to apply for a loan:**



## **Prospectus**

As a general rule, if a public company offers securities for sale (for example, shares or debentures) then they must provide a disclosure document to potential investors. A prospectus is the most common type of disclosure document. A **prospectus** is a legal document issued by companies that are offering securities for sale.

Typically, a prospectus must contain all the information that investors and their professional advisors would reasonably require to make an informed decision about the following:

- the rights and liabilities attached to the offered securities; and
- the issuing company's assets and liabilities, financial position and performance, and their profits and losses.

Although the *Corporations Act* contains a general disclosure test for a prospectus, it does not set out a 'checklist' with all the information it should contain.

In practice, a prospectus typically includes information about the following:

- history of the business
- the company's business model
- risks
- description of management
- how the company will use the proceeds
- financial information
- details of the offer.

The role of the prospectus is to make investors aware of the risks of an investment. Without this information, they would basically have to make investments 'sight unseen'. This disclosure also protects the company from future accusations that it did not fully disclose enough information about itself or the securities in question.

# QUESTIONS

1. Create a table outlining the advantages and disadvantages of the five legal structures.

<b>Legal Structure</b>	<b>Advantage</b>	<b>Disadvantage</b>

2. Distinguish between debt and equity finance. List two advantages and disadvantages.

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3. Distinguish between a secured and an unsecured loan. List two advantages and disadvantages.

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4. Why do you think the process of a business loan application is lengthy?

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5. What is a prospectus and what do they do?

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