BEING ENTREPRENEURIAL

A BUSINESS GUIDE FOR CILS

New York State Small Business
Development Center

and the

The CIL Management Center of the
Western New York Independent Living Project, Inc.

NYS Small Business Development Center
The State University of New York

ACKNOWLEDGEMENTS

This document is a joint project of the RRTC, WNYILP, NIDRR, NYSSBDC and the authors include the following individuals and institutions:

King, James L., NYS SBDC, SUNY Central Administration
Brigham, William, NYS SBDC, SUNY Albany
Hefka, Michael, NYS SBDC, SUNY Buffalo
McCartney, Susan, NYS SBDC, SUNY Buffalo
Morley, Thomas, NYS SBDC, Mercy College
Nowicki, Raymond, CPA, Nowicki & Associates, Buffalo, NY
Thomason, Cindi, NYS SBDC, SUNY Buffalo

The Rehabilitation Research & Training Center on Independent Living Management is a member of The Family of Agencies of The Western New York Independent Living Project Inc.

This is a publication of the Rehabilitation Research & Training Center on Independent Living Management which is funded by the National Institute on Disability and Rehabilitation Research of the US Department of Education under grant number H133B000002. The opinions contained in this publication are those of the grantee and do not necessarily reflect those of the Department of Education

The NYS SBDC is partially funded by the US Small Business Administration. The support given by the SBA through such funding does not constitute an express or implied endorsement of the co-sponsor or participant's opinions, products or services.

BEING ENTREPRENEURIAL

Table of Contents

Quick Start Guide

Is entrepreneurship for your CIL?

There are no guarantees in business. There is no way to eliminate the risks associated with starting a small business. But, you can improve your chances of success with good planning, preparation, and insight. Start by evaluating your strengths and weaknesses. Consider each of the following questions:

Is your team together?

It will be entirely up to your CIL to develop projects, organize time, and follow through on details.

How well do you get along with different stakeholders?

Businesses need to develop working relationships with a variety of stakeholders, including boards, customers, vendors, staff, bankers, and other professionals (such as lawyers, accountants or consultants).

Can your CIL deal with a demanding client, an unreliable vendor, or a cranky receptionist if business interests demand it?

Can you make decisions?

Business operations require decisions constantly and often quickly, independently, and under pressure.

Do you have the physical and emotional stamina to run a business?

Business operations can be exciting, hard work. Can business requirements specify the workdays every week?

Can you plan and organize?

Research indicates that poor planning is responsible for most business failures. Good organization of financials, inventory, schedules, and production can avoid many pitfalls.

Is the commitment strong enough?

Running a business can wear down individuals and organizations. Some business teams burn out quickly from having to carry all the responsibility for the success of the business. Strong motivation and commitment help the organization survive slowdowns and periods of frustration.

How will a business affect your CIL?

The first years of business start-up will be hard on the organization. It is important for team members to know what to expect. The team must be able to trust that the commitment will bring success. There may be financial strain until the business hits breakeven and becomes profitable. This could take months or even years. Can the parent CIL adjust to a drain on assets and some additional risk in the short-term, with the potential for long-term success?

PREFACE – A NEW WAY

A new way…
Can a CIL operate in the for-profit world? An analysis of alternatives, mission, cultures and history, can profits further CILs work?

The collaboration between the New York State Small Business Development Center (NYS SBDC) and centers for independent living (CILs) began in 2001 with two training events designed to introduce not-for-profit centers for independent living to the concept of business planning. The NYS SBDC and the Rehabilitation Research & Training Center on Independent Living Management (RRTC-ILM), a member of the Western New York Independent Living Project, Inc. family of agencies, established a relationship to provide training and business assistance to CILs interested in developing for profit ventures. Following these training events, three CILs were selected to receive in-depth assistance to structure and develop a for-profit venture within their CILs. This manual describes projects in Erie, Pennsylvania, Lynchburg, Virginia, and Marshall, Minnesota that succeeded with the help of representatives from the NYS SBDC, their local SBDC, and the RRTC-ILM. The outcomes of these case studies, along with the general qualitative evaluations from the training and advisement services, measure the success of this collaboration.

A few years ago, a friend referred a CIL director to me who wanted to discuss business opportunities. I did not know what CIL stood for at the time. But, in the world of acronym soup known as government that was not unusual. That was my introduction to Douglas Usiak, Executive Director of the Western New York Independent Living Project, Inc. (a CIL) and the development of a series of projects that had me working and experiencing tremendous highs and extreme disappointments.

Doug gave me a quick introduction to the work of CILs. . My first impression was that of a bunch of well-intentioned people who see the world as it 'ought to be' rather than the sometimes harsh reality of public sector programs and funding. The key thing that caught my interest was that these people were not sitting and complaining. They were looking for new, innovative, and even untried ways of developing resources to ensure that their work would not be interrupted because of public funding losses.

I am the New York State Director of the Small Business Development Center. We are a higher education-based (State University of New York) business advisement, training and research organization. Last year, we advised 20,000+ entrepreneurs, about evenly divided between start-ups and existing small business owners. We trained another 22,000+ entrepreneurs at 452 training events throughout New York State. Our research is usually for a specific business. But we get involved with any topic that affects the small business sector. Last year, the small business owners we advised, invested $282 million in their businesses affecting 13,142 jobs.

Doug Usiak and I agreed that the SBDC would become one of the partners of the Rehabilitation and Research and Training Center on Independent Living Management, a member of the Western NY Independent Living Project, Inc. family of agencies). The SBDC project included conducting two training events, wherein CILs would be introduced to the for-profit business-planning model. We would test the model's application to CILs. We would observe the compatibility of profit decision-making and operations with CIL culture.

The training events were designed to advance CIL managers' understanding of implementing and successfully operating a for-profit venture within a CIL. While for-profit endeavors may be viewed as a major departure from the mission and organizational culture of CILs, they are a valuable alternative if CIL services are to be maintained and expanded in today's challenging environment.

Two training events were held (August, 2001 in Buffalo, NY and January, 2002 in Las Vegas, NV). From those participating, two or three CILs were selected for in-depth development of a strategic business plan to structure a for-profit venture within the CIL. The outcomes of these case studies, along with general qualitative evaluations from the training and advisement services, serve as measures for this section of the project. Outcomes are being evaluated based on contributions of the subsidiary to the parent CIL organization and based on the objectives of that CIL. (Case studies of the specific efforts are included in this workbook)

Some of the project's anticipated outcomes included:

- Measurement of financial contributions
- Revisions to CIL operating procedures
- Broadened vision for the CIL organization
- Greater and improved community interaction
- More pro-active internal governance of the CIL
- Greater public exposure and enhanced image for the CIL, and
- Management revisions to apply the business model to CIL operations.

After the training events, interested CILs were provided with a questionnaire to solicit their conceptual business proposals. Interviews were conducted to assess the receptivity and potential impact of SBDC expertise. A selection team composed of RRTC-ILM and SBDC staff ranked each proposal and selected four viable candidates. We culled this list further, approving three CILs for this project.

The training sessions encouraged questions and identified various concerns that had to be considered before a CIL proceeded to launch a for-profit business. These questions were answered through longer-term consulting engagements or in one-to-one meetings with business mentors from the SBDCs. While the NYS/SBDC is the lead SBDC in each project, the geographic dispersion of the participating CILs necessitated the inclusion of local SBDC staff for localized services. At each participating CIL, a resource team coordinator from NYS/SBDC conducted needs assessments, proposed a service plan to identify needed assistance, and acted as the liaison between the CIL, local SBDC services and research / technical expertise.

As participating CILs entered the consulting phase of the program, outcomes for the project were based upon identified objectives. While growth in financial viability was anticipated, additional organizational objectives that had substantial impact upon the participating CIL were pre-identified. The three CILs selected to participate in this project were located in Pennsylvania, Virginia and Minnesota. The selection committee estimated the probability of success for each project and summarized perceived obstacles and outcomes.

The projects are summarized below. They are described in more detail in the Case Study section of this workbook.

Pennsylvania was the site of an urban real estate deal to purchase the building that the CIL leased, establishing the CIL as a tenant/owner, developing the CIL as a facility manager and subletting extra space to other tenants. Initial data indicated that the building, in relatively good shape, would spin off revenues sufficient to eliminate the CIL's rent and encourage facility expansion, reduce the CIL's costs, thereby lowering overhead. At the outset, this project was viewed as a guaranteed success, with minimal risk, substantial fiscal return, but limited application to the furtherance of the CIL's mission.

Virginia was the site of a community-based project to provide computer technical expertise and support. While market data indicated customer needs and business viability, the CIL lacked unique skills or special advantages that could secure the business model or provide a comparable advantage to the CIL over time. Due to the generic nature of the business concept, this project had greater risk and lowered expectation of success. The contributions to the CIL's mission were perceived as initially limited but with greater potential as the business matured.

Minnesota was the site of a project that was fairly remote but was viewed as ideally compatible with the CIL mission. This project focuses on pre-fabricated ramp construction designed to meet ADA codes. The business had limited competition, significant competitive advantage, and excellent market potential and commercial viability. The project was pre-identified as the project with the greatest long-term potential while directly contributing to its CIL's mission.

INTRODUCTION

This workbook is intended to assist CILs in evaluating their potential to develop and operate a for-profit entity for the benefit of their not-for-profit (NFP) CIL. The idea of being entrepreneurial has great appeal for many organizations for a wide variety of reasons. These may range from financial independence, to getting rich, to being in charge, or to better meet the mission of the CIL during a period of declining or stagnant support.

This project gathered numerous people together to contribute their ideas, share expertise and explore the unique obstacles confronted by CILs across the nation. Each participating CIL agreed to undergo a significant effort to analyze a particular business concept for a profit-making venture and share that experience. The experiences of participating CILs have been incorporated in this workbook to further the understanding and value of this project. For that willingness and commitment, we thank each person and organization that attended one of the three workshops we presented, as well as the five CILs that choose to more fully participate by pursuing or starting a business.

CILs going entrepreneurial performed just like the small business sector. Some CIL projects never launched (died during discussion). Others started, but did not attain success. Others achieved their objectives and attained success.

It is our hope that this workbook will stimulate your CIL's thinking and help to avoid most of the pitfalls that result in added risk, business problems and failures. Applying sound for-profit business techniques to the operations of a CIL can yield significant benefits, even if a separate for-profit venture is not launched or operated by the CIL. Whatever your CIL decides, good luck.

SOCIAL ENTREPRENEURSHIP?

An entrepreneurial venture by a CIL (a not-for-profit organization) may support the CIL's mission or simply advance priority services through added financial support. It is important to determine the CIL's motivation for pursuing a business venture, and define success in advance for the endeavor. The idea of 'social entrepreneurship' combines the passion of a social service mission with business-like discipline, innovation, and determination to achieve the efficiency associated with the private sector.

CIL entities *going entrepreneurial* blur the public/private sector boundaries. Social entrepreneurship includes social purpose business ventures, for-profit community businesses that meet a social need, and hybrid organizations, which mix not-for-profit and for-profit elements (e.g. a homeless shelter starting a business to train employees for a major hotel in hospitality skills). For CIL management, the willingness to adopt, embrace, harness and direct business attributes to the CIL can develop new models of service delivery, and mechanisms to evaluate existing services. It can become an agent of change within the social service mission.

What is entrepreneurship? Entrepreneurship is the driving force behind the processes that create economic activity. Peter Drucker said, "entrepreneurs may not cause change, but are the opportunists who capitalize on change (consumer preferences, technology, style, opinion, etc.)."

It is important to understand the opportunities that change provides for CILs. Will a business change a CIL or provide a response to changes that are taking place in the marketplace? What change must your CIL understand?

Every business does not represent entrepreneurship. The opening of a franchise location usually does not have the innovation and change elements of entrepreneurship. For CILs, innovation and change may occur in the CIL rather than in the business venture. Resourcefulness distinguishes entrepreneurial management from administrative management. Entrepreneurial management pursues opportunities with less regard to needed resources, presuming additional resources can be obtained if the opportunity has a sound business justification.

Understanding these differences is important for CILs. Usually CILs are administratively managed. An entrepreneurial CIL reconciles divergent management styles and focuses upon the positive contributions of each style for longer-term success. While not mutually exclusive, administrative and entrepreneurial management styles must co-exist if CILs are to prosper. Each management style can benefit from the other style for survival. Agreement within the CIL Board, management and staff, to pursue change brought about by entrepreneurship will change the CIL's organizational culture.

CILs have a social purpose and mission that are integral to ongoing success. Mission-related impact is a critical measure of the evaluation for CILs when exploring entrepreneurship. Ideally, profits can be justified because of the added support to the CIL's mission. The profits, or avoided costs, can have positive impacts upon the CIL in terms of quantity and quality of services and improved lifestyles of consumers.

A CIL's evaluation of an entrepreneurial activity includes understanding of the market and the marketplace for the opportunity of success. CIL's usual organizational mentality distributes resources. It does not sell them for value as a business. CIL support is most often driven by community need and social commitment, not by demand. The 'market factors' within CILs are not disciplined compared to business markets.

Public benefit organizations, such as CILs, seek to identify needs and improve or enhance the lives of clients and service recipients. In business, the focus on needs is defined by *choice* and characterized by *preference.* This notion of need preference is central to entrepreneurial success.

The challenge for CILs is similar to entrepreneurs - the pursuit of a goal (business idea or service mission), but not beyond a point considered reasonable. CILs should set specific goals and attain buy-in from the entire organization if realistic expectations of results are to be attained.

Businesses can be successful by making small, incremental innovations or changes to existing products or services. Success does not require wholesale or dramatic change. A small change can produce striking results. The strategic plan should be readily understood and garner the required cooperation and support within the organization to be successful.

Entrepreneurs are typically characterized by scarce capital, which does not limit their efforts. This is often due to the participation of others. If CILs are to be entrepreneurial, then the critical characteristics to look for include: collaboration, organizational involvement and participation. It is often necessary to bring others into the business venture to address strategic requirements. For example, if the CIL has production capability but lacks a distribution network, perhaps another organization is needed to market the product.

The CIL should understand the strengths and weaknesses of the organization and anticipate change. The level of change, innovation, and opportunity may force the CIL to re-examine basic operations, test assumptions, challenge ideas, share information and draw on the collective experience, skills and knowledge. Entrepreneurs pursue resources (from others) and use them to effect change. If a CIL is committed to providing services in the future, no matter what the level of public support, then an entrepreneurial attitude should be explored.

This workbook provides CIL management with questions to ask when considering a change to enhance their CIL's stability. Most people are content with doing the same thing, whether in the public or private sector. Change brings risk about the unknown. Acceptance of risk can be difficult for organizations and individuals. The key to being entrepreneurial is the ability to evaluate risk, plan for contingencies and refine the unknown into an expected future outcome. This process is known as strategic planning and is the focus of this workbook.

BACKGROUND OF THE PROJECT

The business advisors providing expertise to CIL entrepreneurs answered many of the same questions raised by entrepreneurs in the private sector. It was recognized that, if the level of risk could be overcome, the opportunity to advance the mission of the CIL by structuring a for-profit unit would benefit the consumers and the community. The question of accepting risk initially started out as a secondary consideration, because a basic and incorrect assumption was made - that project participants were pre-committed to entrepreneurial development. Risk proved to be the critical question for every CIL in the project.

The participating CILs were screened from a large pool of applicants who were aware of the changes effecting public benefit corporations. They were selected to represent a cross-section of the entrepreneurial process. This assumed commitment by CILs (management, staff and Board) was anticipated after internal questioning, but was soon recognized as not having been committed to prior to training. The unexpected lack of commitment to accept risk was an error. Training was enhanced with each event with greater inclusion of risk management with the CILs. Board members were more actively included to help build internal support for the entrepreneurial activity. The management and Board of Directors for most CILs were not in full agreement on the advisability of operating a for-profit venture within the CIL. This conflict was consistently the most serious obstacle confronted by the CILs who participated in this project.

IS AN ENTREPRENEURIAL VENTURE FOR YOUR CIL?

A discussion format was used in each of the three multiple day training events offered to interested CIL managers and Board members. This introduction to the project selection process stimulated discussion. It became apparent that many of the CIL participants had *either* key management *or* key Board members that perceived entrepreneurship as an opportunity. But few CILs had both team groups with a consistent vision. These differences stimulated discussion. However, the inconsistency created obstacles that detracted from enthusiasm for entrepreneurial change. Ultimately, a written agreement of CIL management and CIL Board to pursue entrepreneurial activities became a key determinant in the criteria for the project's success.

The following summary is the starting point for a CIL interested in creating a wider base of support for combining for-profit activities. Discussions on these and related topics may be found throughout this workbook. Abraham Lincoln is credited with properly stressing the need for planning and preparation. When asked how he would deal with cutting down a very large tree that was estimated to take six hours, Mr. Lincoln stated that first, he would spend five hours sharpening his axe. We hope you will sharpen your mission and plan for profits.

STRATEGIC PLANNING AND FOR-PROFIT VENTURES – IS IT FOR YOUR CIL?

Each discussion is meant to focus on an actual venture. That venture may come from a variety of sources, such as CIL management, the Board of Directors, community needs or a single staff member. The focus should be on the stakeholder commitment and analysis of a specific definable venture. The actual selection of the venture is less important than the understanding of the impact the venture will have on the CIL: what risks are associated with a venture and how the decision makers view the resulting changes to the CIL. The position of the CIL's key stakeholders will be made clear through the commitment process. Revisions to the proposed venture may be included over time to deal with specific concerns.

Exercise: *Take a few minutes and look at your CIL's Mission Statement. Discuss whether the Mission Statement encourages or even allows you to be entrepreneurial. If not, decide what revisions are necessary to have an entrepreneurial activity conform to the Mission Statement and prepare those revisions for formal adoption by the Board of Directors.*

The feasibility of the venture is tied to the motivation for the decision. For a CIL, motivations range from cost containment to profit incentives to support the mission, to combinations of mission support, added services, to cost containment. (Cost containment is the reduction of CIL expenses, allowing savings to be reprogrammed).

An example of cost containment would be: a CIL purchasing the building where the CIL is renting space. Rising rental costs increase the total CIL operating expenses. The entrepreneurial option might be to purchase the building, helping to fix or stabilize these rental costs through a mortgaged purchase. An added benefit would be the potential income of subletting unused building space to other organizations or small businesses.

Exercise: *Can you list the advantages of owning the building as well as the risks of ownership? Where do you think the greatest obstacles would come from if your CIL tried to buy its building? Note: This situation will be reviewed in a case study later in this workbook.*

The ideal CIL for-profit venture might be one that supports the mission of the CIL, while contributing to the services or needs of the CIL consumer community. CIL consumers rely upon goods and services from the business community. Occasionally, required consumer goods or services are not readily available, or not available at an acceptable cost, means of delivery or product/service feature. This non-availability represents an opportunity for the CIL to respond to that need through a business venture.

By owning the business venture, a CIL determines the price (may choose to limit profits in favor of responding to social needs) and improves access to goods or services. For-profit ventures have incentives through taxes and accounting practices that may financially reward the CIL. These incentives are discussed in greater detail in the financial section and tax appendix of this workbook.

The business plan is the starting point for most successful business ventures. Failing to plan for the success of the business is to plan to fail. Any CIL that is thinking about starting a for-profit venture is, by definition, an innovator and undertaking additional risk. The business plan is critical to controlling the level of risk associated with a start-up business venture.

Reference – *see Case Study #3 for some additional information on risk tolerance in the CIL environment, assessment and the role of management and the Board in the planning process.*

The initial task for the entrepreneurial CIL is to undertake an environmental review (political, financial, stakeholder and customer) of the influences that may impact the venture. The political review sensitizes the CIL's planning group to the criticism of unfair competition charges by any existing business in the same sector or market area. This concern can be dealt with through careful definition of the customer target market and clear explanation of CIL business objectives, as those objectives relate to the CIL's mission. The establishment of a for-profit venture also deals with the unfair competition charge against not-for-profits by creating a level playing field (financially and through taxes) with businesses in the private sector.

Staying within the CIL's mission and balancing the needs of the CIL service community help handle stakeholder concerns and customer justification. It is important to confront early criticism with full disclosure of the CIL venture and deal with any expressed concerns before commitments are finalized. This will reduce the political risks before your CIL has made investments in the venture.

HOW TO INTEGRATE THE VENTURE INTO YOUR CIL MISSION

The entrepreneurial approach allows the CIL's advocates to anticipate the changes that take place to be successful. Venture ideas always begin with a market analysis within the CIL geographic area and the identification of unmet or partially met needs, ideally where the CIL may have a competitive advantage. Being able to draw a direct link between fulfilling the CIL mission and the operation of a for-profit venture provides the justification for the venture within the CIL. In trying to identify a for-profit business to pursue, the fundamental objective of increasing CIL support by making a profit can be refined by the objectives of the CIL and meeting the overall CIL mission.

As the starting point, is recommended that CIL staff and Board attend a brainstorming event to solicit input. This event should be a facilitated, inclusive meeting, starting with basic questions about the CIL's future and encouraging open discussion. The following series of starter questions might be posed to stimulate the discussion:

- Is the CIL accomplishing everything in its mission? Or, should more be done?
- Can the CIL expect regular increases in support, at least large enough to meet increasing costs?
- What attributes of an entrepreneur do the staff and Board possess?
- Is there a historical background in the CIL or stakeholders that creates knowledge within a sector or class of business?
- Why is a for-profit venture necessary? (By answering this question, your prime objective comes into focus.)
- Within the marketplace, what specific consumer or community needs are not being met? If the CIL were to fulfill those needs, can it be done at acceptable levels of:
    - Price?
    - Service?
    - Perception?
    - Risk?
- The impact of earning money with a business venture may impact the traditional CIL supporters. How will the change in the CIL be perceived, and by whom?
- What drives the selected market for the business venture? Are there goods or services that the CIL can offer that better meet the needs of the community, supporters, funding sources, consumers and customers?
- Are there regulatory concerns? Does the CIL propose to meet:
    - Safety standards?
    - Labor standards?
    - Wage rules?
    - Liability questions?
- What new and existing resources and assistance providers can be called upon?
    - Federal, State, public, traditional and innovative sources?
    - Can the existing business community be supportive?

  - Other sources - governmental and private sector?

- Can the CIL's targeted service recipients be benefited by the venture?
- Does the CIL intend to remain in the business forever? Is an exit strategy appropriate so that a successful venture might be sold off as an ongoing business after the venture has been established?

The business plan will recognize the objectives of the CIL and anticipate the business life cycle. Planning is actually organizing change, which does not end with the successful launch and operation of the business. The CIL real strategy may be to force improved or accessible goods or services from the private sector by demonstrating the need and viability, intending to divest the business as soon as possible and simply recoup any investment. This is an exit strategy for the business. Launching a venture and planning to divest an ongoing venture at a significant profit can create a CIL reserve venture capital fund for the CIL's future innovation.

Reference – *See Case Study #1 for additional information on integration of the business idea with the role, environment and mission of the CIL and working to fit the pieces together throughout the planning and implementation process.*

Every business goes through the highest risk period of start-up, when the business concept is still being proven. Sales are low or non-existent; no revenues (cash) are being generated to cover expenses. Unless anticipated, this negative cash-flow situation causes tremendous concern among management. Detailed sales projections and careful attention to marketing allows for early adjustments to the plan to attain targeted projections.

As start-up proceeds successfully, the business enters a growth stage. Sales increase (dramatically or gradually) and may cause similar cash flow problems as those experienced during start-up, but for very different reasons. During growth, increasing sales require additional working capital to fund supplies and added expenses, (e.g. the timing delays of billing and collections, work in progress, etc.). Although profits, on paper at least, are growing, the cash requirements of the business may continue to necessitate that funds are invested in the business. Short-term borrowing is often required. As the business proceeds through the growth stage, the short-term borrowing requirements may not lessen. Ongoing growth may require expansion, where additional term borrowing matches the life of the expansion. Following the growth stage, businesses enter a mature phase.

The mature business is marked by very predictable sales with only slight growth corresponding to inflation or market share growth. During this period, cash flow (income after expenses plus non-cash expenditures) significantly outpaces cash expenditures and the highest level of surplus cash is achieved. This is usually the period of highest value for the venture. It may be planned to trigger an exit strategy to sell the business at its ongoing venture value, often significantly more than the fair market value of assets. By revising the business operation, the period of time associated with the mature stage can be lengthened to generate larger profits for extended periods.

Finally, businesses enter the decline stage, where sales tend to lag behind inflation or actually decline. And management tends to cut expenses and investment as the only way to maintain cash-flow margins. At this point, either the business will necessarily evolve toward a new market or cease operations. The photographic industry is going through the decline stage brought on by digital technology. Technological obsolescence has become an increasing threat to many businesses in every sector. This technology risk is another threat that is often overlooked by smaller businesses.

At each stage, the business plan provides the blueprint or yardstick by which management evaluates progress. Early identification of problems can be made to allow for corrective action before the situation becomes critical. If the business is off-track, what should be done? The question to ask is whether the business is ahead or behind projections. Obviously, the response varies widely. But either condition can spell disaster. It is advisable to anticipate how external events will impact your business. For a CIL, public sector funding changes have an impact on every program. In the business sector, external forces can disrupt the business operation even more. Anticipating the disruptions allows for planning that responds to, and further reduces, the risk.

The entrepreneurial CIL should build a consensus among stakeholders and focus the business planning on an actual business and the resources, commitments and risks associated. The following chapters will help to introduce key factors involved in the planning process that every CIL should consider. It is hoped that the reader will use this information to successfully analyze the decisions necessary to be entrepreneurial as a CIL.

Reference – *See Case Study #4 for additional information on coordinating the business idea with the role and resources of the CIL and doing so in the context of a quantified look at the marketplace.*

Exercise: *One early step that can prove helpful is to see your (or your CIL's) profile as an entrepreneur and small businessperson. The following exercise was developed by the US Small Business Administration to help gauge an individual's entrepreneurial strengths. Working with your Board and management, think about why you would like to start a business and what traits you can identify that you think will help you to be successful in business? Remember this is simply a tool. It is fun to take and fun to interpret, but keep it in perspective.*

For each question, circle the Yes, Maybe or No answer that best describes you and/or your CIL. You must answer ALL questions for the test to be accurate.

Y M N I am persistent.

Y M N When I'm interested in a project, I need less sleep.

Y M N When there's something I want, I keep my goal clearly in mind.

Y M N I examine mistakes and I learn from them.

Y M N I keep New Year's resolutions.

Y M N I have a strong personal need to succeed.

Y M N I have new and different ideas.

Y M N I am adaptable.

Y M N I am curious.

Y M N I am intuitive.

Y M N If something can't be done, I find a way.

Y M N I see problems as challenges.

Y M N I take chances.

Y M N I'll gamble on a good idea, even if it isn't a sure thing.

Y M N To learn something new, I explore unfamiliar subjects.

Y M N I can recover from emotional setbacks.

Y M N I feel sure of myself.

Y M N I'm a positive person.

Y M N I experiment with new ways to do things.

Y M N I'm willing to undergo sacrifices to gain possible long-term rewards.

Y M N I usually do things my own way.

Y M N I tend to rebel against authority.

Y M N I often enjoy being alone.

Y M N I like to be in control.

Y M N I have a reputation for being stubborn.

Count all of your Y answers and multiply time 3. Count your M answers and multiply times 2. Add the two numbers together for your score.

If you scored between 60 and 75, start that business plan – you have the earmarks of an entrepreneur. If you scored between 48 and 59, you have potential but need to push somewhat. You may want to improve some skills in weaker areas. This can be accomplished by hiring someone with these skills. If you scored between 37 and 47, you may not want to start a business alone. Look for a business partner who can compliment you in the areas where you need some help. If you scored below 37, entrepreneurship may not be for you. You will probably be happier and more successful working for someone else. However, only you can make that decision.

Remember, this is only an exercise based on characteristics found in many entrepreneurs. It is by no means fool proof, but it should be fun and a good starting point as you evaluate your feelings about pursuing a business idea.

TAX CONSIDERATIONS: AN OVERVIEW

Note: This material is not to be deemed wholly comprehensive or authoritative. The reader is advised to consult with appropriate legal and tax counsel before pursuing a particular course of action.

This section helps the entrepreneurial CIL gain an understanding of the tax regulatory environment in which they are planning a for-profit venture. This section covers broad issues of taxation, structure, and conflicts or opportunities when the not-for-profit develops for-profit ventures. It is intended to provide awareness of areas in which CILs may need to do further research, to provide questions that should be asked in going forward, and, to help understand the implications and significance of a for-profit venture in a non-profit environment.

Additionally, this section is intended to demonstrate the complex nature of the issues and the importance of seeking qualified professional advice. It is important to note that many topics of taxation and accounting in for-profit and not-for-profit ventures are subject to interpretation and may vary from situation to situation. We cannot state strongly enough the importance of professional advice.

Listed below are summary areas and questions of general concern and interest to a non-profit looking at a for-profit venture. Please refer to Appendix A for more detailed information and reference sources.

BASIC BUSINESS CONSIDERATIONS

A CIL evaluating a for-profit business is searching for an opportunity that promotes the CIL's primary mission by enhancing resources, services or access for its consumers. We must remain mindful that a CIL is in an environment that places mission fulfillment above financial benefit and that a for-profit venture may conflict with this non-profit mission. It is important to review what the implications may be for the organization with the Board, stakeholders, supporters and staff and assess preparedness to deal with these challenges.

Many not-for-profit organizations have learned that self-reliance is a means of long-term survival, especially as more organizations compete for limited public funding. To remain in sync with their primary mission, some not-for-profits have developed assets and skills that are both mission-related and valuable in the marketplace. Other not-for-profits have chosen unrelated ventures for more purely commercial opportunities, opting to pursue the mission through enhanced resources. It is important to structure whichever for-profit opportunity is chosen in such a way as to not interfere with the not-for-profit status of the CIL.

Throughout the evaluation and planning process, a major consideration to keep in mind is that the rules at the federal and state level that demand ***strict adherence to primary organizational purpose over personal enrichment.*** This requires a clear separation between for-profit and not-for-profit activities. The separation must be real and the activities on both fronts must be reasonable in their respective context.

The CIL should consider the reporting, filing and disclosure requirements of the non-profit entity because these may complicate the ability to maintain confidentiality of trade secrets, know-how and similar competitive information. Clear separation of activities and roles can minimize this challenge.

CILs should be aware that disclosure of information could lead to incorrect public perceptions, which may raise additional questions. For example, "Was 'public' money used to begin the for-profit venture?" Is the public benefit entity 'competing' with private sector suppliers with the assistance of tax dollars?"

Exercise: *Set a meeting with key leaders of your CIL to discuss access to qualified professional assistance, the for-profit opportunity in terms of community perception, which will the for-profit be competing with, and, develop a list of the short- and long-term* *pros and cons to determine how the benefits will outweigh the risks.*

TAX CONSIDERATIONS

The following section identifies some of the basic concepts needed to frame your questions about the tax-related restrictions and examples appropriate for CILs. These items are covered in greater detail in IRS Publication 598 which also covers he Unrelated Business Income Tax (UBIT).

PROHIBITION AGAINST PRIVATE INUREMENT (PERSONAL BENEFIT):

The prohibition against private inurement means that the person(s) who created or control a tax-exempt organization, including its members, employees, and other insiders, may not acquire any of its funds or assets, except when:

- They are paid "reasonable compensation," or related expenses, for services rendered; or
- They pay an amount equal to the "fair market value" of any of the organization's assets they may receive.

LOBBYING ACTIVITIES

A for-profit organization may expend significant resources lobbying various levels of government to achieve preferences. Unfortunately, the not-for-profit is governed by IRC Sec. 501 (c)(3) which prohibits lobbying activities and can result in the imposition of an excise tax if not-for-profit funds are expended for lobbying purposes. During planning, ascertain if lobbying or advocacy by the CIL will be an essential component of your for-profit success.

Not-for-profit organizations are allowed to provide educational information and respond to governmental inquiries without violating the law. If CIL management has questions in this area, they are encouraged to seek clarification from legal counsel. Serious violations can result in loss of the CIL's 501(c) (3) tax-exempt status, termination of certain officers or directors, or a variety of other sanctions.

QUID PRO QUO CONTRIBUTIONS

In business, there are limitations on business-related expenses, such as meals and entertainment expenditures, sporting events and other forms of market or client development. The for-profit can spend larger sums of money treating gifts as taxable income to the recipient, and adding the gross amount of the benefit(s) to tax withholdings. However, there is no requirement of public disclosure. A CIL may entertain benefactors, but there are constraints dealing with excessive entertainment and mandatory disclosures.

A business can only deduct actual gifts in under $25 unless the recipient reports the excess as taxable income, but there is no public disclosure.
Conversely, a CIL must disclose the value of any benefits, other than incidentals, which are received by contributors in exchange for donations. This is an example where scrutiny and disclosure requirements are higher for the CIL and may adversely impact business opportunities, while furthering the need for accurate CIL record keeping.

UNRELATED BUSINESS INCOME TAX (UBIT)

UBIT is applicable to a non-profit entity that has earned income unrelated to its primary purpose. IRC Sec. 513 (a) defines an unrelated trade or business as any trade or business not substantially related to the exercise or performance of the organization's exempt status. When a CIL has an income opportunity, it may not automatically need to set up a for-profit organization. When a new business develops, it may be small enough to handle within the CIL without serious tax-related consequences to the not-for-profit structure. This might correspond to the early stages of a business venture and provide a try and see window for exploring a business opportunity. This is an area of wide interpretation and professional advice should be secured before proceeding. Additionally, the IRS website at http://www.irs.ustreas.gov/bus info/eo/unrel.html offers some discussion on the definition and determination of the UBIT.

The concept of UBIT should not be automatically viewed as an impossible hurdle for the CIL, which is seeking to protect its tax-exempt status and enhance economic viability. However, the officers and board members should be cognizant of the potential problems and address the issues as part of the overall business plan.

BUSINESS STRUCTURE AND LEGAL FORM

Based upon these decision-making tools, the CIL must determine the most favorable legal structure in which to grow and manage the for-profit business.

Typically, a CIL could start a business as the equivalent of a sole-proprietorship if the development of a profitable concept arises from the normal activities and services provided by the CIL. This approach does not offer the goal of having the for-profit business operating as a separate legal entity. As a sole proprietorship, the CIL is exposed to all of the risks and tax implications associated with the new business. While convenient, this approach is not generally recommended because of the risk to the CIL.

One of the significant elements of selecting a business structure is risk management. Though many of the specific risks of the new activity can be addressed by proper insurance coverage, the development of managerial controls, systems, and accounting can address operational exposure areas. In many cases, it is advisable for the new business to be segregated from the CIL for legal liability. This can be done through **a limited liability company (LLC),** which limits the risk exposure of the CIL. This will not protect the CIL from tax and UBIT rules, private inurement or general disclosure. It does provide a 'corporate-like' protection.

There are several forms of business that may make sense in any situation. This is an area that requires professional advice to assure the correct choice.

THE CIL "CONTROLLING" A NOT-FOR-PROFIT (NFP)

If the business is an acceptable activity, the CIL may isolate the activity within another newly formed entity within the lead or parent not-for-profit, providing oversight through an element of common leadership. However, the Boards of Directors should not be identical, nor should the senior management.

Exercise: *Spend some time with the current leadership of the CIL to discuss and identify skills and talents among existing leadership that may be useful to a for-profit entity. Seek to identify key managers and board members that may be sought to augment one or the other (but not both).*

Reference – *See Case Study #1 for additional information on how the skills and resource base that is currently available can provide a good jumping-off point for the business idea.*

THE CIL WITH A FOR-PROFIT C-CORPORATION SUBSIDIARY

In situations where a CIL owns a controlling interest in a for-profit corporation, care should be taken during start-up that the for-profit is not simply an alter ego of the CIL, and should be combined for the purpose of determining the entity's tax-exempt status. Barring fraudulent or sham transactions, where the parent is not involved in day-to-day activities of the for-profit, or where the officers and Boards of Directors are not identical, the IRS will respect the separate identities.

It is important to have good systems in place to properly allocate joint costs, such as in a shared space facility, or to have an appropriate interest rate set for loans from the parent to the for-profit subsidiary, or to set pricing or rates (like rent) at fair market values.

Exercise: *Many CILs administer grants and similar income streams with fairly complex accounting systems in place. Meet with your internal and external accounting professionals* *to determine if the existing systems can handle the requisite separation. Determine any new or enhanced accounting software or systems that may be required to meet IRS regulations.*

THE CIL WITH AN S-CORPORATION SUBSIDIARY

A CIL may elect to utilize an S-corporation as the for-profit entity. Though generally seen as a bad idea (earnings of the S-Corporation, which are attributable to a tax-exempt organization, are automatically treated as UBIT income), you should consult professional advisors before making this determination.

THE CIL AS A PARTNER IN A PARTNERSHIP (INCLUDING LIMITED PARTNERSHIPS)

The IRS takes a negative position on partnerships where a not-for-profit is a significant or managing partner. One key exception occurs in cases where the not-for-profit's role was strictly passive and not contrary to the not-for-profit's primary objective, as might be the case in an arms-length investment partnership.

FINANCIAL STATEMENT AND DISCLOSURE CONSIDERATIONS

The American Institute of Certified Public Accountants (AICPA), the Financial Accounting Standards Board (FASB) as well as several other sources promulgate the rules by which books and records are kept. When a CIL reports information in financial statements, the information must meet certain standards to be useful to readers and meet regulatory requirements.

A CIL involved in a for-profit activity needs to understand the requirements and limits of disclosure and reporting in order to present accurate information and proper disclosure while not divulging trade secret information, such as marketing or production costs. Professional advice is a key element of your decision making process.

THE BUSINESS PLAN: THE CIL'S PRIMARY BUSINESS COMMUNICATION

The CIL must develop the strategic business plan – the road map for the business. CIL stakeholders should be assisted in evaluating the business idea or concept, asked to define customer characteristics, help formulate a marketing strategy, evaluate operations and begin to project basic financial and performance data for the venture. The process of going through these steps is important for the successful launch of a business, and it may be the only way for a CIL to ensure key stakeholder buy-in as support of the business.

WHY DOES A CIL NEED A STRATEGIC BUSINESS PLAN?

A good business plan encourages research that allow the CIL to draw conclusions and plan in response to those conclusions, helping fix mistakes before they happen to the business. It helps to identify the strategies and implementation tactics that are most likely to succeed in the CIL's venture, select products, services and markets that can be accessed and supported, and gives all members of the organization the information necessary to move toward a common goal and success. If a CIL stakeholder wants to advance the mission of the CIL through a business subsidiary, the CIL must be prepared to manage and organize a business effectively. The business plan is the best way to develop the venture at reduced acceptable risk, set targeted goals and measure progress.

A good strategic business plan focuses on markets for a product or service, anticipates future needs, monitors progress and is proactive - not reactive - in managing resources.

A good strategic business plan provides a valuable management tool which integrates all facets of the operation - whether profit or non-profit.

A good strategic business plan defines where you are, anticipates where you are going, and how you are going to get there, encouraging everyone in the organization to work together.

Reference – *See Case Study #1 for additional information on how the CIL anticipated the impact of space availability on the future business operation – and planned the solution!*

If you have never prepared a business plan before, this workbook will help you. The questions, outlines, exercises and samples presented cover how to gather information and assemble the plan.

The next step is to share the data across the organization and focus upon the outcomes needed or desired. The process of planning allows key CIL stakeholders to analyze the strengths and weaknesses of the business idea, identify market opportunities, anticipate market changes and detail the actions required to reach goals, while allowing the CIL to draw on the expertise and strengths of stakeholders through a participatory process of knowledgeable buy-in.

The first step to a good plan is to develop a **Summary.** This short, one page document, takes the broad view of the issues and invites contributions from all levels of the CIL. By simplifying the planning process, it enables the team to quickly make an assessment of the business concept.

Exercise: *Develop a simple description of the business idea and key outcomes. For example, the CIL wants to purchase the building currently being rented.*

The purposes are to:

a) Reduce cash outlay currently used for rent through offset with rental revenue,

b) Create an equity resource to improve long-term financial stability of the CIL, and,

c) Provide a more flexible real estate environment that will allow for programmatic expansion and/or contraction in response to client needs and business activity.

Then, review this statement with key leaders of the CIL, as this statement will essentially become the overall strategy and goal statement of the project.

The next step is to develop the details, incorporating feedback from the more extensive plan. The plan is eventually going to be a complete statement of the business operation and almost look like a book. Each chapter of the book is a specific plan in itself - the marketing plan, sales plan, finance plan, operations plan, and the underlying data to support each strategy, tactic and business action.

STRATEGIC BUSINESS PLAN – EXECUTIVE SUMMARY

The one page Executive Summary is an overview of the business. It is a brief description that sets the vision, the implementation and the outcome into one easy to understand statement. After reading the Executive Summary, the reader should understand what the CIL wants to do, how the CIL will do it and how the CIL will define success.

While the **Executive Summary** can be written last (after completing the nine key areas identified below and after completing the financial projections), it is preferable earlier in the process. The summary highlights the key ideas of the plan, the measurement of success, competitive advantages and links all of the facets of the idea to help the reader understand the plan without significant explanation from individuals associated with the CIL. Approach the Summary as a statement of the business, identify issues or opportunities, and try NOT to spend more than an hour writing them down. This initial Summary is only meant to communicate the preliminary vision. The details will be worked out over time.

Take action, share the Summary with key CIL stakeholders, and invite their reaction and involvement in the Business Plan Development Team (or whatever catch phrase you prefer). If stakeholders do not respond, reach out to them and press for a response. Remember that a negative response early is much better than later on, after the Team has committed resources to the detailed plan. This early buy-in through participation is presented as critical to CIL success in entrepreneurial activities.

Exercise: *After you have completed the preliminary work on each section, try to summarize each section in one or two sentences. Establish the flow between sentences or strategies, demonstrating the connections. Try to establish the overall logic and reason of the plan. For example:*

"The CIL will establish a wholly owned subsidiary LLC to purchase the 30,000 square foot building housing 12,000 square feet of CIL offices and program space. The key objectives of this effort will be to reduce rental cost, build equity and increase facility flexibility."

"There is strong demand from area professional services firms for small offices with parking and transit access. We plan to provide conventional rentals and 'shared services' space, utilizing existing CIL office systems such as voice and data communications. There is a shortage of this type of space and service offering in the area with most facilities showing better than 95% occupancy."

"Marketing and sales will be handled by a new Facilities Manager. We will develop market awareness through close contacts with our stakeholder community and small firms offering services to our client base, which is currently more than 35 service providers in the legal, therapeutic and supply sectors. As a single facility, the new Facility Manager will oversee day-to-day operations including build-out, usage, utility billing, signage, etc. The new position will report to the CIL Executive Director, to the CIL Finance Director for fiscal oversight and to the CIL Board for periodic reporting."

"The purchase price of the building is $1,250,000, and an additional $250,000 for first year operations and build-out of rental space, for a total of $1,500,000. Key factors in our financial plan are a $125,000 cash contribution, 15 year commercial financing at 6%, rental charges at $12 per foot (the current local market supports $13-$15/foot) and a 75% first year occupancy of the 18,000 square feet we do not now occupy. This will produce rental revenues of $13,000 per month in the first year, and, at 85% occupancy in the second year produc-

ing slightly over $15,000 per month. Allowing for an $11,600 monthly mortgage payment and operating costs of $5,000 per month, we should close the year at a net monthly cash loss of less than $2,000 – an $8,000 improvement over our current rental expense. When we achieve 90% occupancy in year 3, we move into a positive monthly cash flow of $1,500. In addition, we will be saving $120,000 in annual rental expense."

"This plan details the resources, usage and integration of the purchase of the building, the impact on cash flow and the benefits to our CIL. Essentially, this plan takes our CIL from an annual expense of $120,000 to an annual gain of $138,000. This is a significant resource improvement that will be used to further the mission of the CIL and the services to consumers."

BUSINESS DESCRIPTION

The Business Description is a short statement of what the business is and what it does. In a concise manner, describe the business.

Example: *The CIL Real Estate LLC is a corporation established to acquire and operate the office building at 123 Main St., Smithville, NY. Up to 40% of the facility will be occupied by the CIL, up to 25% will be structured, rented and operated as a 'shared services' office facility offering voice, data and systems access for tenants, and, the remaining 35% will be structured as rental office space targeted to professional service firms with market interests among the client base of the CIL. The overall aim of the Real Estate LLC is to reduce the operating expense of the CIL, build long-term equity and support the services of the CIL through contribution of profit and expense reduction.*

MARKET ANALYSIS

The **Market Analysis** describes **who the customers are.** How many customers are out there? What are the characteristics in terms of size/age, location or common traits? How can they be identified (e.g., by industry, by size, etc.)? Is the product or service available from other sources? How big is the market? How much is spent by customers? What are the past, current and future market trends? Is the market segmented (broken down by characteristics like color or material)? Is the market a commodity (everything is seen as the same)? Is it customized and unique? What is the geographic area of the market? What part of the entire market will the business target?

1) Market Size - Present figures and factual information on the size of the market for your product or service. Obtaining numbers may seem difficult, but the effort will be worth it. Programs like the Small Business Development Center can help you find sources of information and, in some cases, conduct original market research. Be sure to include information on the following:

a) How much is being spent on the product or service (by all customers)? Or, if the product is new, how much is being spent on alternative products or services?

b) Is the market expanding or contracting? At what rate?

c) How is the market changing? Define the characteristics that are changing?

d) Where will the market be in five years? How much will customers be spending? Will population or age projections show an impact on the future of the market?

2) Market Profile - Describe the existing or potential customers for your product or service. Expand on the information in the Business Description section. This expanded detail should include:

a) Who will buy? If customers are individuals, what are their characteristics such as; age, income level, education, family status, etc. (customer demographics)? How many customers are there? If customers are businesses, what kind of businesses? What do they have in common? What size(s) are they? Are products branded or private label, etc?

b) Where are customers? Are they located in a particular region or area? Describe the characteristics of the region as it may relate to your products, e.g., if your business makes winter coats, your customers are principally in colder regions.

c) Why will the product or service be purchased? Expand on the customer need that the product or service meets and why the customer will select your product over a competitive choice. Will your product better meet a feature or benefit need? For example, with athletic footwear, Velcro brand closures are a feature. But if the sneakers make you jump higher and run faster, that is a benefit. The perception of a benefit can be as important in the marketplace as an actual benefit.

d) When will the product or service be purchased? Is it seasonal and, if so, what is the seasonal aspect? Does it tie in with other products or events? Is there a limited timeframe for the product?

e) What is the customer expectation for the product or service in terms of price, quality, service, delivery, packaging, etc.?

Reference – *See Case Studies #1 and #2 for additional information on how the market data was developed, how additional cost effective resources were brought in and how the data are used to support the decisions in the Business Plan.*

Exercise: *Review some numbers for the potential customers of your product or service. Remember, this is the time to be as quantitative as possible.*

Smithville, NY, has seen robust growth in recent years in demand for office space. According to the Real Estate Reference Co. annual summary of office space statistics, Smithville has grown from 650,000 square feet of prime office space to more than 1,000,000 square feet over the last 5 years. Rental rates have kept pace with this growth in available space, rising from an average of $9/sq. ft. to $14/sq. ft. over the same period. A significant component of this growth has been in 'shared services' - space that is rented ready to use, equipped with phone systems, computer networks and data communications, access to *conference rooms, a reception area and similar attributes. This type of space has been extremely popular among professional services firms seeking access to larger facilities than might otherwise be cost effective. Long-term growth prospects are attractive, with Ollie's Office Space Monthly quoting industry experts as expecting 7% - 10% annual growth in this segment over the next 10 years.*

The market for small to medium sized office space (1,500 – 3,500 sq. ft.) has shown excellent stability, with moderate growth over the last 10 years in the Smithville area. The new number of leases reported by Lisa's Leasing Stats has shown consistent, moderate growth, averaging 5% annually, over a 15 year period with fluctuations of less than 2 percentage points a year.

This space is frequently rented to larger service providers in the medical, legal and technical areas. According to statistics from the NYS Dept of Labor, the number of service providers in these segments continues to grow. It is anticipated that this growth will continue on a long-term basis. The growth shows a direct relationship to the aging of the population – a trend that the US Dept of Commerce indicates will be continuing for the next 33 years. Given the natural link between these medical providers and our client base, we will target the 173 medical practices, with more than 3 physicians, located within 75 miles of Smithville as our market of rental customers. Add to this market size estimate the average 3 new similar medical practices begun each year, and a sustainable market for space is projected.

PRODUCT OR SERVICE ANALYSIS

This is where you must present evidence to prove (and to convince the reader) that **there is a need for the product or service – and that there is sufficient demand to support the business proposed. It is not enough to believe in the product or service, it must be shown.** This section must:

First, identify the need for the product or service, Second, show how the product or service meets that need, and

Third, show how to sell the product or service at a profit.

Exercise: Working with the key proponents of the business idea: Describe what the product or service is and why customers will purchase it. What are the features or benefits of the product or service that are better than the competition (e.g., better quality, cheaper, faster, and softer)? What need does the product meet for customers? How does the product or service satisfy demand? Is the product protected by a patent or other exclusive contract? What makes the product unique – is it branded or private label?

COMPETITION

Identify the companies that provide a similar or an alternative product or service. Be sure not to overlook competition from outside the area. Describe these competitors in terms of importance, size, location, target market, distribution or other characteristics. This section works well as a chart.

Remember: A good place to start this research is the local yellow pages in the telephone directory and/or industry catalogs. Describe all identifiable strengths and weaknesses, such as competitor #1 has a large dedicated sales force, #2 has no local service site, etc. Do not forget to evaluate how the competition operates:

- What is done right and what is done wrong?
- What appears to be the competitor's strategies in markets, sales and operations?
- Is there a competitive weakness that your business can improve upon and exploit?
- Is the market large enough for an additional business or will an existing business be forced out of the market?
- Can a new business survive long enough to effectively compete?

Describe the companies and products that are the competition. Do not forget to include imports if they are a factor in the market. Remember, even new products have some type of competition. For example, if the business will be selling cash registers, a look at personal computers would be appropriate as competition as a similar point-of-sale data processing equipment.

Exercise: *Work with the leaders and managers of the product to identify the direct and indirect competition. Include the following and limit detailed analysis to the top 5 or 6 competitors:*

How many companies will be competing against the business? Where are the businesses located? How long have they been in business? How does the competition distribute the product or service? What is the respective market share? What are the strengths and weaknesses in marketing, operations and finance, of competitors? And what are their strategies? How does your product compare in terms of price, quality, service, design, delivery or other features? Do you intend to take market share away from the competition or will you be creating a new, niche market?

Some of this information may seem difficult to obtain, but get as much reliable data as possible so you know the competition. Start research with readily available tools, like the telephone book yellow pages, catalogues, sales literature, industrial and commercial directories, libraries, trade associations, etc. This section is often set up as a chart or table/matrix listing the same categories for each competitor and highlighting the weaknesses or missed opportunities.

MARKETING STRATEGY

This section describes **how to reach customers and sales goals.** Think of **why customers will choose your business over the competition.** Identify and describe how to get sales by answering the following questions:

How will specific markets be reached through advertising or promotion?

How will you price the product or service?

How will the product or service be distributed?

For example, will sales be through retailers, by direct mail, sales representatives, regional distributors, and sales people? How will promotion be handled – a brochure or data sheet, radio/television, etc.? Where and when will advertising take place? How much will be spent on advertising? Will you have a market niche that can be targeted at less cost? How will service policies affect marketing?

This is the section where you integrate and assess the market, the competition, your capabilities and how to set the product or service apart from the others. The following are important elements to consider when developing the strategy: trends in the market, competitive strengths and weaknesses, voids in the market, market niches, technology, lower costs (production or sale), advertising, public relations, promotions, quality, and service.

Reference – *See Case Study #4 for additional information on the importance of looking beyond your assumptions at additional market areas using numeric models and quantitative measures.*

Be sure to address each of the following areas:

Product Features - Review the features of the product that meet the needs or demands of the marketplace. Discuss how those needs are met. Describe related features and design elements such as: How the product will be packaged in terms of function and promotion. Does the package need to preserve, protect or display the product (or all three)? Is shipping a concern? Are there environmental concerns or concerns by the retailer or final seller of the product? How will the label affect the product?

In addition to promotional information, are there regulatory concerns for label content (e.g., ingredient lists, nutritional data, warnings, directions, UPC codes, UL listing, ISO 9000, etc.)? How will you register and use trademarks and identifying images? Discuss the plan to develop, establish and protect the image. Remember: if it is unprotected and can be used by anybody entering the market. What is the investment worth?

Warranty terms are sometimes a critical purchasing decision point. What will the warranty terms be, why, and, what does the market expect? Service may be another significant purchasing decision point. What will the service policy be and how will it impact the business?

Pricing - Price can be the key element in a marketing strategy and must be carefully thought out. Several price development theories exist that may apply. Consider the following: How will the price relate to the cost of the product? How will price relate to the cost of marketing and promotional efforts? Is discounting required in the marketplace? How will the price compare to competitive products? Is the difference worth it? How will the price relate to what the market is able and willing to pay? Products targeted for price sensitive or low-end markets cannot succeed at a high price. How will the pricing strategy enable the objectives to be achieved? How does price relate to the distribution methodology? Is multi-tier pricing required? What will the impact of retailer/distributor markups be? Will these add-ons make the product too expensive?

Distribution - Describe how your product gets from you to the customer and how that relates to marketing methods. Consider the following: What are the available methods for distribution (e.g., direct sales force, distributors, retailers, mail order) for similar products? What are the methods used by your competition? Will your method be different? Why? Can this differentiate your product? If you use a direct sales force, how large will it be? What will sales representative growth rate be? How will salespeople be compensated? And, what expenses will you incur beyond salaries? If you use dealers or distributors, how many do you need? Where will they be? How will you determine these factors (e.g., geographically, demographically, logistically)? And how will you hire them? Describe, in reasonable detail, how the distribution method will support your strategy and reach your objectives.

Promotion - Describe how you will generate awareness of your product among potential customers. Include the following: What promotional activities are used by the competition (e.g., advertising, publicity, literature, trade shows, etc.)? What activities will you plan to use? How and why will they differ from the competition? How much do you plan to spend on these activities as a total dollar amount and as a percentage of projected sales? How will your activities reach the customer at a purchase decision-making point? How will you maintain awareness for uneven sales decision cycles? How will you develop brand loyalty? How will you schedule activities? What will your media or production schedule for literature or advertising be to meet market requirements?

Exercise: *Select one of the marketing areas above and, working with just the key managers of the project, answer all of the questions in one section. Review your answers with an outside resource like the SBDC to begin developing feedback and critical questioning.*

OPERATIONS

How will you obtain or produce your products or provide your service? At a minimum, consider the following:

Location & Space Requirements - Where is/will the business be located and why? What type of space is needed? How much space? What will it cost? What may be unique or special about the space (e.g., a sophisticated assembly operation may require air conditioned manufacturing space)? What is the breakdown of space by type (e.g., 20% office, 50% manufacturing, 30% warehouse)?

Regulatory - What is the regulatory environment? Is the area you want zoned for your type of operation? Are emissions or discharges a concern? Does parking or truck traffic count as a concern?

Equipment Requirements - What type of equipment is needed for manufacturing or services? How much does the equipment cost? Is special operator training necessary? Are special licenses required? How much will the equipment cost to operate?

Personnel Requirements - Human resources are often the most important component to an organization. How many people do you need to operate? What skills do they need? What kind of experience is needed? Are the people available? What are the prevailing wages? Is training required? Are unions a factor? Provide a roster of existing operations personnel and a schedule of planned hires by date of hiring and associated expense.

Production or Service Operations - Describe the process of manufacturing or providing the service and include the advantages of your process, capacity, quality control systems, potential suppliers, secondary sources for raw materials or subcontract services. Try to breakdown fixed and variable operating expenses, both current and projected. Variable expenses will change due to the volume of sales. Describe the relationship of cost to sales.

Exercise: *Working with the key project managers, develop a brief summary describing how you will make or obtain your product, or, provide your service. Be specific in describing: how much space or special electrical service or special plumbing may be needed for machinery, storage, packing and handling? What type of machinery is required? How much warehouse and office space do you need? Are there any zoning or regulatory [OSHA, EPA, etc.] concerns? How many employees will you need, and, when will you need them? Are special skills required? What employee training will be required and how will training impact operations? Describe the specific process steps employed in making the product or providing the service. Take your summary to an external resource for review.*

MANAGEMENT

How will your business be managed? Investors and lenders must be convinced that you can manage the business successfully and can attract needed new staff. Describe the following:

Organization - Explain how the company is organized with a brief description of the role of each manager and provide an organizational chart or job descriptions. Job descriptions should include the specific tasks, responsibilities, authority and relationships to other employees of each job.

Key Managers - Show how the management team has the necessary functional skills in production, marketing, finance, and general management. Describe their experience with your product in a related industry. Provide a brief biography of managers, list past positions, accomplishments and career highlights. Include resumes in an appendix or as an exhibit.

Management Weakness - Identify any weakness in the management team and explain how you will address the weakness. Can critical missing skills be provided by recruitment, training or subcontracting?

Compensation - Describe the compensation plan that will be used and how each manager will be paid. Will there be a bonus, profit sharing or other incentive plan? If so, describe the incentives in detail. If the plan does not provide payment for management/ownership, that is a mistake that will affect the credibility of the plan.

Ownership - What role will the parent CIL perform? Who will be the point person for ownership? How will the for-profit venture interact with the not-for-profit CIL?

Board Membership - Identify who will participate on the for-profit's Board of Directors, why they were selected, how each one will help the business.

Exercise: *Begin by listing who will be active in the business. What experience is the staff bringing to the business? How do the backgrounds of staff relate to the business? Provide resumes or descriptions of the backgrounds of the people that will be* *working with the venture. Identify support persons and services, such as accountants or attorneys. Outline job descriptions to identify tasks and responsibilities necessary. How will uncovered job requirements be met?*

FINANCES

In this section describe **how much the business will cost.** If the venture is already operating, provide financial statements or tax returns for the last three years. How much business is being done? Is the business making a profit? How much?

Reference - *See Case Study #2 for additional information on the importance of understanding the financial implication of the business idea and its potential impact on existing CIL operations. Also see Case Study #3 for a good understanding of the need to set performance targets related directly to the 'cost of capital,' accessing that capital and providing measurable outcomes in the plan.*

If a new venture, estimate how much it will cost to launch and operate the business until breakeven is reached. For example, the new machine will cost $3,000 plus $500 for installation. Will the new machinery or equipment help you stay competitive? Will you have a competitive advantage? Identify all the costs of your product. Can you make a profit?

Estimate the total operating costs in the business by reviewing: rent, wages, benefits, insurance, advertising, printing, telephone, utilities, travel, sales expenses, etc. Set up sample financial schedules to help project three years of business. If the business borrows money, include the proceeds of the loan and monthly repayment of principal and interest. As you develop the numbers, write down any assumptions that are associated with each estimate.

Use the sales and cost information developed in preceding sections to prepare projected financial statements. Use a professional to assist in developing this information because it must be formatted in a very specific manner and in compliance with FASB and GAAP. Be sure to provide back up for the assumptions used in the projections. Include the following statements: Source and Use of Proceeds/Funds, Cash Flow Projections, Income Statements and Balance Sheets and Statement of Changes in Working Capital.

Source and Use of Proceeds/Funds -

Whether the CIL, a lender or investor is funding the business, they need to know how much money is necessary. Where will funds come from? How will they be paid back? And, how will funds be used? For example, a business might need $25,000 in loans in phase one, (with a 7 year term carrying a 12% interest rate) to be used for the purchase of two $10,000 pieces of equipment and one $5,000 computer. A $30,000 loan in phase two (with a 5 year payout at prevailing rates 24 months later) will be used for two additional pieces of equipment and improvements to the facility ($3,000) and worker training ($7,000). The Source and Use of Proceeds statement is frequently done as a table, identifying the major income items, the major expense items (e.g., machinery, computers, office equipment, etc.).

Reference - *See Case Study #2 for some additional information on the importance of directly relating the budget of the business idea to the budget of the CIL.*

Cash Flow Projection - This statement identifies sources of cash, categories for cash paid and operating expense categories. This statement helps manage cash requirements in both short and long term views. (A sample form is provided below.) Cash flow projections should be monthly for the first year and at least quarterly for subsequent years.

Income Statements and Balance Sheets - These statements are the standard measure of how a business is performing. If already in business, provide statements for the last three years. Plans usually provide quarterly projections for three years, and annual projections for years 4 and 5. If an accountant prepares the information, provide audited or reviewed statements. The income statement shows revenue, expenses and calculates profit or loss, an overview of the operations of the business. The balance sheet identifies assets and liabilities of the business in a snap shot, showing the business current status. (Sample forms may be found below.)

Break-Even Analysis - This analysis helps to understand the specific relationships between costs and sales. At what sales volume do profits start? At what volume do profits dip due to incremental expenses (such as new machinery, overtime, etc.)? Break-even analysis looks at the business operating levels and is a key evaluation for the project.

Assumptions - For each line in the pro-forma [projected performance] financial statements, indicate any assumptions upon which estimates are based. For example, if spending $10,000 on a new piece of production equipment, have a quotation from the supplier or a copy of a price list. Support raw material price estimates with quotations, support labor rates with prevailing wage studies (available in libraries) or union summaries. Assumptions may flow from earlier sections on objectives, marketing strategy, operations, organization, management and timing. If the plan calls for ten salespeople, reflect the salary costs assumed. Assumptions are among the most likely areas for challenges to the business plan. Test the assumptions and be confident in the ones presented.

Spread Sheets - Computer spreadsheets are very useful for answering **'what if'** questions and looking at results under different assumptions, conditions or scenarios. An SBDC advisor can run the numbers through computer models to give a better feel for the dynamics and interrelationships of the business. This will create a better understanding to manage the business and respond to questions from lenders or investors.

SUPPORTING INFORMATION

Provide copies of brochures, photos, news clippings or other relevant information that will help others better understand the proposal. For example, a photograph helps someone understand the product. A copy of a competitor's brochure shows how your product compares. If the business is a franchise, attach a copy of the franchise contract, etc. Provide any information that clearly displays your knowledge of the business and the competition. Keep all materials clear and concise.

TIMING

Prepare a schedule that reflects major milestones in the business plan for the next five years. This can be effectively presented using a chart and brief explanations. Address major or significant goals and extend the list to a monthly operating schedule. Be sure to list planned product introductions, changes in workforce or management, noteworthy sales events (e.g., trade shows, selling seasons, tie-in promotions), changes in facilities, significant changes or events in the marketing strategy or the marketplace (e.g., pending regulatory changes) and significant changes to the customer base.

EXHIBITS/APPENDICES

Exhibits and appendices provide supportive details for the plan. Include resumes of all key personnel and managers. Job descriptions for other personnel, brochures to explain products or services, maps showing the location of the business, prior tax returns, prior financial statements, accountant's reports and quotations or supporting assumptions for the financial section, competitive sales literature and demographic tables support the marketing section, copies of patents or similar documentation, flow charts for production, and, any other supporting or explanatory information that can be referenced by readers of the plan.

WRAPPING UP THE BUSINESS PLAN

Working from the information developed, you are ready to assemble the Business Plan for the new venture. Include the **Title Page** – name, address, phone and contact information. You would be surprised to see how many great plans do not give the reader any way to contact the author.

Organize the plan as a collection of individual chapters. The chapters are drawn together and integrated by senior management in the **Executive Summary** to show the fit, relevance and operability of each section. Remember to include a **Table of Contents** and any other assistive tools that improve readability but do not complicate the plan.

SUMMARY

The business plan will be read by many individuals: from the Board of Directors to funding agencies to banks and even customers and employees. The Summary lays out the fundamental keys to your CIL's success and convinces the reader that this is a viable business idea that they should support. The business plan is the sales catalog for the business, getting all parties focused on the same ways to reach success. The Summary must present the plan in a way that is logical and makes the reader want to continue.

Keep in mind that the Summary appears first. But you write it last - after the plan is completed. It should not be longer than two pages, and should include:

- A brief description
- Market potential and competitive assessment
- Product advantages and market need
- Objectives for the business
- Market strategies
- How to make the product or perform the service
- Experience with the product or service
- Projected sales and profits
- Financing needed
- Where financing will come from and how it will be used
- How the financing will be repaid, if required

Obviously, you must write very concisely. Give only the highlights and refer to supporting detail in the other sections of the plan.

SAMPLE BALANCE SHEET

As of				
Current Assets				
Cash				
Accounts Receivable				
Inventories				
Prepaid Expenses				
Other Current Assets				
Total Current Assets				
Fixed Assets				
Land				
Leasehold improvements				
Equipment				
Vehicles				
Other fixed assets				
Sub-total fixed assets				
Less				
Accum. depreciation				
Total Fixed Assets				
Total Assets				
Current Liabilities				
Accounts payable				
Current portion LTD				
Accrued expenses				
Other current liabilities				
Total Current Liabilities				
LTD net of current				
Owner's Equity				
Paid-In capital				
Retained earnings				
Total Owner's Equity				
Total Liabilities & Equity				

SAMPLE INCOME/OPERATING STATEMENT

	Q1	Q2	Q3	Q4	Total
Gross Sales					
Less returns/allowances					
Net Sales					
Less Cost of Goods Sold					
Gross Profit					
Operating expenses					
Advertising					
Bad debts					
Bank charges					
Credit card fees					
Depreciation					
Dues & subscriptions					
Insurance					
Interest					
Maintenance & Repairs					
Postage & Supplies					
Rent					
Salaries & Wages					
Taxes					
Telephone					
Travel & Entertainment					
Utilities					
Other operating costs					
Total Espenses					
Profit/(Loss) before taxes					
Income Tax expense					
Net profit/(loss)					

SAMPLE CASH FLOW

Note: The Cash Flow statement should be done monthly for the first year and at least quarterley for all other years.

	Q1	Q2	Q3	Q4	Total
Cash on hand					
Cash Receipts					
Sales					
Collection of credit accts					
Loans or Financing					
Total cash receipts					
Cash paid out					
Purchases					
Gross wages					
Payroll expense					
Supplies					
Repairs/maintenance					
Advertising					
Insurance					
Interest					
Delivery & travel					
Accounting & legal					
Rent					
Salaries & wages					
Taxes					
Telephone					
Capital purchases					
Utilities					
Other expenses					
Loan principal payments					
Total Cash Paid Out					
Cash at end of month					
Essential Operating Data					
Sales volume $'s					
Accounts receivable					
Bad debts					
Inventory					
Accounts payable					

THE CIL AND SBDC PARTNERSHIP IN ACTION

Social impact organizations have traditionally operated with significant support from government funding programs. Consequently, as funding has become erratic, CILs have been forced to adapt cost cutting and revenue generating programs. Because of these changes, creating business models, marketing plans, and developing entrepreneurial skills have become a priority. Most CIL staff recruitment has not identified intrapreneurs that recognize and seize business opportunities. Therefore, outside resources and assistance are imperative to facilitate changes in the planning process.

In 2001, the NYSSBDC and the Rehabilitation Research & Training Center on Independent Living Management (RRTC-ILM), a member of the Western New York Independent Living Project, Inc. family of agencies, joined together to introduce entrepreneurial practices and principals to CILs around the nation. The relationship between SBDCs and CILs established training and business assistance to those CILs interested in developing for-profit ventures. Entrepreneurial thinkers often have business models in mind. So, the training events provided CIL staff with the fundamental tools to objectively analyze the feasibility of each potential venture.

Three CILs were chosen to further develop and structure a proposed for-profit entity, with intensive assistance from SBDC representatives. In each case, a NYSSBDC staff coordinator headed each assistance team, combined with a local SBDC staff member.

Successful outcomes for CILs were identified to include:

- Significant (for-profit) financial contributions to the CIL
- Improved business operational procedures
- Focused vision for the CIL organization and consumers
- Greater and improved community interaction
- More pro-active internal governance of the organization

- Greater public exposure and enhanced image for the CIL program
- CIL management core competency growth to apply the private business model to overall operations

The initial business plan development projects selected were from Marshall, Minnesota, Lynchburg, Virginia, and Erie, Pennsylvania. In a second round of selection, a project from Troy, New York was selected. These four projects are summarized in the following case studies at different stages of development. (A fifth project, selected for development in the second round, did not proceed beyond the identification stage due to a conflict with the project mission).

CASE STUDY #1 – THE SOUTHWESTERN CENTER FOR INDEPENDENT LIVING (SWCIL) - MINNESOTA

This project was unique because it created a profit business that reinforced the social impact of the CIL by providing well-constructed and affordable residential ramps for individuals with disabilities. SWCIL collaborated with the Minnesota Department of Corrections to Serve Program to construct and install modules and ramps at minimal cost because individuals paid only for the cost of materials and a $250 setup fee.

A key component of the success of this project was the ability of the CIL Director and Board of Directors to recognize the need to develop a for-profit construction business to fill the specialized niche of access ramp construction at lowered cost. This commitment led to the successful implementation of a thorough market analysis at the outset of the project.

The marketing study revealed that there was a strong unmet market demand with little competition (few contractors in the area built ramps of quality) that met code requirements. With this market information in hand, the SBDC and CIL worked to develop a marketing plan, feasibility analysis, business plan, human resource analysis, and promotional strategy for the business.

The following elements combined to achieve progress:

- The CIL Director committed to the for-profit construction company.
- The CIL Board was 100% behind this effort.
- The CIL had knowledge of the construction industry and a passion for building ramps and home adjustments for people with disabilities.
- The CIL's former construction site (where ramps were pre-assembled) was at the Lyon County Fair Grounds. It was a good location, except when the fair was set up (two months). During those months, the CIL discontinued all construction activities.
- The CIL built a building outside of town in an industrial park. The building has room for expansion and three work crews find the space perfect. The CIL does not lose this site during the peak summer construction season as it did with the Fair Ground site.
- The CIL purchased a flatbed truck to transport pre-built ramp units.
- The crew leaders are outstanding, but labor issues have created problems. The CIL utilizes work release prisoners. The problem was not with the work. The problem was with the free cost because the CIL is a not-for-profit.
- A LLC (limited liability corporation) for the ramp building business was set up by an attorney and a CPA.
- A professor of marketing at SW University, Marshall, MN, worked under the direction of the Marshall SBDC to develop the market study for the CIL. A phone survey of the entire region was conducted to determine the percentage of the population in the next five years that would benefit from a home modification to improve mobility or independence.
- The research team proved, beyond question, the market for ramps.

- Very little competition existed with few contractors in the area building ramps of quality that met code requirements.
- Projections indicate that SWCIL will significantly increase services and revenue over time while meeting client needs.

Although strong demand existed for access ramps, the relatively high costs of customized ramps in rural and economically challenged regions limited the potential. By seeking an innovative approach, CIL and Department of Corrections staff combined mission objectives to jointly meet their respective mission objectives. The inmates, overseen by the Department of Corrections, were charged with a public service requirement ideally associated with the learning of a skill set that could useful after release.

The program is receiving referrals from as far as one hundred miles away. The business purchased a building and retains a full-time construction crew for this revenue generating side of the organization. The project has contracts to construct ramps for the county, a daycare center, and seniors.

Recently, SWCIL completed a new business plan that expands the scope of residential services beyond ramp construction. The new business model will encompass remodeling and retrofitting homes into accessible dwellings for people with disabilities and seniors. Services include bathrooms, kitchens, doors, and any other project that will make a home accessible to the residents.

CASE STUDY #2 – COMMUNITY RESOURCES FOR INDEPENDENCE (CRI) CIL - PENNSYLVANIA

The CRI project was a real estate transaction. It appeared to be the most basic of the business projects. CRI wished to purchase a 26,000 square foot building valued at $1,300,000, in which they were already renting 60% of the total space. The basic plan was to reduce overall occupancy costs, generate cash flow, and provide better long-term growth opportunities in terms of future space requirements and expansion of the building. The purchase of the building would establish CRI as tenant /owner / facility manager, while subletting extra space to tenants which would generate extra revenues to offset mortgage costs and reduce CRI's expenses.

An initial assessment indicated that the building was in good condition, would generate revenue sufficient to eliminate CRI's rental costs, and encourage facility expansion. The project was viewed as a guaranteed success at the outset, with minimal risk and substantial fiscal return, but limited application to directly further the CIL mission.

A development team was assembled that included business specialists from the NY and PA SBDCs, a CPA, a non-conflicting local real estate developer, and CRI's Controller. Team members initiated research on local real estate market conditions, pricing, terms, occupancy rates and general characteristics.

Subsequently, fiscal modeling spreadsheets to aid in the prediction of financial impact of changing operating scenarios were developed, along with calculations of beneficial tax treatments for the sale of depreciated property to enable inclusion of such options with the purchase offer.

The team identified several issues of strategic import, which required additional research as the project moved forward. These included:

- budget reductions,
- declining state support,
- sharply increased insurance costs, and,
- possible significant changes to the regulatory environment which may require the spin-off of one-third of their current operations.

As a result of cooperative efforts, a strong strategic business plan for CRI's acquisition was developed. The situation specific plan created a comprehensive response to all overall operating issues including marketing options for space rental, development of a shared services business unit, and broad outlines of the lease requirements with the CRI operating as landlord.

The purchase of the building was delayed due to budget restrictions and sharp reductions in rental market demand, which created a less favorable cost / benefit analysis for the project. It became clear that there was reluctance within CRI's management and Board to assume the added level of financial risk associated with the purchase of the building. (Further reflection upon the differences among various CIL projects yielded the opinion that the pure cost savings nature of the project had not created the linkage to the CIL mission found in other projects.) The assistance team believed that significantly more time should be devoted to programmatic improvements that would be possible with the budgetary savings to further justify the apparent risk.

CASE STUDY #3 – THE LYNCHBURG AREA CENTER FOR INDEPENDENT LIVING (LACIL) – VIRGINIA

LACIL formed a technology consulting business called the Center for Independent Living Technology Services (CIL Tech). CIL Tech developed a comprehensive business model that sells and services computer hardware, networks, and software to profit and non-profit organizations in the greater Lynchburg area. They also provide free training with the purchase of new equipment and conduct specialized classes in various areas of computer science. This business is based upon a pledge of confidentiality and guarantees quality and responsive services.

Initially, the CIL staff faced challenges in convincing their Board of Directors of the viability of the project. The concept of utilizing scarce CIL monetary resources for a higher risk enterprise was nearly inconceivable. Similar to private sector companies requiring a comprehensive and well thought-out business plan to convince bankers for support, the CIL was faced with a reluctant Board of Directors. The CIL turned to RRTC-ILM project to help strengthen the case for commitment of funding. CIL management required assistance in setting sales goals, identifying projected costs, and employment and legal issues. These are difficult concepts to explain from a non-profit's perspective.

As the business plan progressed, the Board of Directors requested a presentation by the Business Advisement Team and the SBDC representative to allay their concerns. Following this presentation, the Board of Directors authorized $15,000 in seed capital money to fund the project start-up. In less than six months, the CIL Tech group generated over $26,000 in billings for services provided. This start-up phase sparked development of an aggressive advertising campaign targeting businesses and not-for-profit organizations. With the closest competition an hour away, the venture had little direct competition and appeared to have significant growth potential.

Walter Sabin, LACIL Executive Director, explains the overall impact the project partnership has had on his organization.

"For LACIL, the Going Entrepreneurial project began more than three years ago and has had significant, positive, and long term implications on the development and "culture" of our organization. Our project has been called "CIL Tech," which is short for "Center for Independent Living Technology Services," and began as a strictly for-profit venture. It has evolved to a continuing cost center for our organization that is generating some revenue, albeit, not profits yet. While we have not mastered the art of making profit, our corporate culture and ways of thinking have been forever changed to advocating for the "entrepreneurial spirit" in our planning and operations. In short, this has involved our Board and Management to often examine our activities within at least two perspectives:

1.There is a "program" side to our corporation that involves our mission, programs, services and initiatives, and

2. There is a "business" side to our corporation that requires entrepreneurial thinking, for-profit methods and quality customer services.

It is a stretch for nonprofits to reach from providing needed services to providing services/ products that the free market will pay for, including the profit margins. We advocate for the continuance of this nationwide project, and will remain grateful for the mentoring, education, partnership building and other opportunities that developed as a direct result of our participation. Thanks for a job and innovation well done."

CASE STUDY #4 – INDEPENDENT LIVING CENTER OF HUDSON VALLEY (ILCHV) – NEW YORK

ILCHV's entrepreneurial project compliments and strongly enhances the CIL's mission. With assistance from the RRTC-ILM Going Entrepreneurial project, ILCHV has developed a newspaper targeted toward people with disabilities. The name of the newspaper ***Independence Today.*** Currently, the organization uses a website to keep people with disabilities informed on local and national issues. Transition to print media is a natural transformation.

ILCHV has an informal network of freelance writers who will be engaged for content along with wire service stories covering issues of interest to people with disabilities. The current website has some advertising, but with the convolution of web-based information, creating revenue is more difficult. An initial assessment revealed that the CIL was compassionate. Previous efforts to launch a publication were unsuccessful, largely because they had been attempted without a comprehensive plan for implementation.

The development of the business plan has been slow, but steady. As with any operation, balancing time between existing CIL program management and project planning has been difficult. The ever-changing process addressed many concerns; most importantly, re-development of the target audience. At first, the network of over 500 CILs nationally was viewed as ardent supporters. ILCHV realized that ***Independence Today*** addresses issues across all disabilities, so broadening the reach of the publication will enable the newspaper to attract a larger and more diverse base of advertisers.

Other issues that have evolved and are being addressed through ILCHV's business plan include:

- staffing,
- capacity considerations,
- advertisement sales,
- profit and loss expectations, and
- frequency.

The plan should be completed within the next three months, followed by the implementation phase of the project.

APPENDIX A

TAX CONSIDERATIONS: AN OVERVIEW

This section is designed to help the CIL entrepreneur to gain an understanding of the tax regulatory environment in which the CIL is planning a for-profit venture. This section covers issues of taxation, business structure, and conflicts or opportunities when not-for-profit develop for-profit ventures. **Note: This material is not to be deemed wholly comprehensive or authoritative. The reader is advised to consult with appropriate legal and tax counsel before pursuing a particular course of action.**

BASIC BUSINESS CONSIDERATIONS

A CIL looking for a business structure is searching for an opportunity that may promote the CIL's primary mission by enhancing or improving its resources. The CIL is in an environment that usually places mission fulfillment above financial benefits to the CIL's management, directors, board members and parties related to the CIL. Not-for-profit (NFP) laws in most states and IRS regulations grant such entities the privilege of operating without the burden of an income tax, and in some cases, without the imposition of sales and real property taxes.

Tax-exempt status is granted to a variety of organizations, but the five most common exempt organizations are:

501 c (3): An entity organized and operated exclusively for the purposes of the following activities: religious, charitable, scientific, and literary or education, testing for public safety, amateur sports competition, or the prevention of cruelty to animals or children.

501 c (4): Civic leagues, social welfare organizations and local associations of employees operated to promote community welfare through charitable, educational or recreational activities.

501 c (5): A labor, agricultural or horticultural organization.

501 c (6): A business league, chamber of commerce, real estate board, board of trade or professional football league, operated to improve business conditions.

501 c (7): Social or recreational clubs.

In 1995, all not-for-profits reported total assets of $1.9 trillion and revenues of $899 billion. 501 (c) (3) organizations represented 12.4% of the U.S. Gross Domestic Product. The IRS estimated that it received 80,000 applications for tax exemption in fiscal year 2001. Out of need, most not-for-profits have learned that self-reliance is the best means of long-term survival, with every religious, charitable, cultural, scientific, educational, and civic organization competes for limited public funding. In an attempt to meet its mission, more NFPs are developing assets and skills, which often have application, and value, in the marketplace.

Given the desire for survival and the competing desire of serving the "primary mission," the CIL is caught in the competition for resources. Congress and the Internal Revenue Service realize that tax-exempt status gives any NFP a unique advantage over for-profit businesses. Public misuse of this privilege would have a monumental negative impact on the national spirit for charitable support. Therefore, abuse of NFP status serves as grounds for termination of exempt status. However, Congress does recognize that there will be times when an NFP will face opportunities that may serve the common good of the people, the government, the NFP and business. Therefore, NFPs are recognized as having the potential to develop for-profit subsidiaries that will not affect the basic NFP status.

For example, ideally, a college is a place of higher education and learning. However, academic knowledge without practical experience gives rise to an incomplete education. It makes sense for students and academia to participate in creative endeavors, which may result in new inventions, medications, and scientific theories. Rather than punish the college for its profitable creations, the Internal Revenue Code may, under certain circumstances, impose an income tax on the profits of the endeavor, called the unrelated business income tax (UBIT), allowing the NFP to keep the profits of the unrelated business.

However, an NFP's activities vary substantially from its primary purpose and focus, the resources of an unrelated business activity may no longer retain the not-for-profit status and revocation of the tax-exempt status takes place. The loss of NFP status for a CIL would be catastrophic and avoided, but the operation of non-exempt activities, as a for-profit venture, eliminates the potential challenge to the NFP status.

The NFP world is charged with rules at the federal and state level, which demand strict adherence to the primary purpose over personal enrichment. There is constant criticism of fund-raising activities that benefit the fundraiser more than the intended NFP. These excessive costs to administer the NFP's fundraising efforts or administration of resources are considered abusive. As such, most states require audited financial statements, which segregate the expenses between direct costs for the primary purpose and administrative overhead. Tax returns, such as Federal Form 990, clearly disclose the compensation of key officers, employees and directors. Financial statement footnotes are required to disclose activities of the organization, significant fundraising events, and payments to parties, regardless of materiality.

While this open approach is vital to maintaining the public trust, it may have a negative impact on the confidential nature of some very profitable trade secrets. Key officers of a NFP are questioned about large compensation packages and perks that for-profit businesses readily bestow upon employees, such as bonuses and golden handcuff contracts that guarantee the ongoing confidentiality of the business.

The disclosure of special compensation packages may cause a for-profit business to have its key employees be wooed away by competitors. There are fiduciary standards which limit an NFP's Board of Directors' abilities to assume risk, unless the risk is directly required in the course of promoting the NFP's primary mission. For example, the Board of an NFP cannot take risks with funds which are restricted for the granting of scholarships and fellowships, yet, a for-profit entity is required to commit all of its resources as collateral for bank loans that require funding.

Finally, in the court of public opinion, how would an NFP be viewed if its primary focus was public education about the perils of alcohol abuse, but it promoted its for-profit venture by hosting a cocktail party for an investor? Dichotomies such as this between the for-profit and NFP world must be reconciled.

Beyond issues of public perception, there are basic accounting and operational issues. For instance, the NFP must compete for the services of talented people while saddled with budgetary constraints that limit upward mobility. How can the average NFP expect to hire talented managers under these circumstances? When the NFP further complicates this situation by developing for-profit operational entities, two incompatible ledger systems and rules for tax compliance may overwhelm CILs with shared costs that do not generate a net benefit.

These basic considerations associated with CILs operating a for-profit enterprise add complications. These issues must be addressed and opposing viewpoints need to be reconciled in the business plan model. The reconciliation must receive approval of the CIL Board, its chief management, and operating and financial officers. The buy-in process by key stakeholders results in the discovery that the commitment and skill set necessary for the venture is present.

TAX CONSIDERATIONS

The following section provides the CIL reader with some basic concepts geared toward a specific definition of the tax-related restrictions and examples appropriate for CILs, including examples cited in IRS Publication 598, which describes the Unrelated Business Income Tax (UBIT).

PROHIBITION AGAINST PRIVATE INUREMENT (PERSONAL BENEFIT):

This prohibition means that the person(s) who created or control a tax-exempt organization, including its members, employees, and other insiders, may not acquire any of its funds or assets, except when:

- They are paid "reasonable compensation", or related expenses, for services rendered, or
- They pay an amount equal to the "fair market value" of any of the organizations assets they receive.

The Taxpayers Bill of Rights 2 includes penalties, referred to as **intermediate sanctions,** against individuals who enter into "excess benefit transactions" with a 501 c (3) or c (4) organization. On July 30, 1998, the Treasury Department issued proposed regulations to clarify certain key terms used in the application of the intermediate sanctions.

An **"excess benefit transaction"** occurs when the NFP provides an economic benefit to a **disqualified person** that exceeds the value of the consideration given by that person. A 'disqualified person' is anyone in a position to exercise **substantial influence** over the NFP's affairs. Disqualified persons include:

- Family members of the insider
- Entities owned 35% or more by the insider
- Voting members of the NFP's governing board
- The NFP's president, chief executive officer, chief operating officer, treasurer or CFO

- Any person who has or shares ultimate responsibility for implementing decisions over the organization's management, administration, operations, or financial assets

- Any persons who exercise substantial influence based upon a facts and circumstances test.

Persons deemed not to have substantial influence include: employees who are not **highly compensated** by definition (earning less than $85,000, subject to annual inflation adjusted rules promulgated by the Treasury), if they are not otherwise disqualified and are not significant contributors (defined as one who gives at least $5,000 and the gift is at least 2% of total contributions).

The penalties, which are 25% of the excess benefit increasing to 200% of the excess benefit if the benefit is not repaid, are assessed against the disqualified person. In addition, an officer, director or trustee who willfully participates in the excess benefit transaction is subject to a 10% penalty.

While the Treasury Department has offered extensive advice in the definition of a disqualified person, the term **substantial influence** has the potential to be elusive. NFPs are required to keep **adequate records** to document compensation decisions, especially where revenue-sharing arrangements exist. The relevance of the private inurement issue is important when considering compensation and contracts relative to the startup of an entrepreneurial enterprise within the confines of a CIL.

LOBBYING ACTIVITIES

A for-profit organization may expend significant resources lobbying various levels of government to achieve specific results. For instance, inventors of new medicines or medical devices may need to influence Medicare and health insurance legislation in order to have the costs of those medicines or devices reimbursed by insurance coverage. Unfortunately for the NFP, IRC Sec. 501 (c) (3) prohibits lobbying activities, and such excessiveness can result in imposition of an excise tax.

However, even in the NFP arena, organizations are allowed to provide educational information and respond to governmental inquiries without violating the law. If CIL management has questions in this area, they are encouraged to seek clarification from legal counsel. A serious violation of the law can result in loss of the CIL's 501(c) (3) tax exempt status, termination of certain officers or directors, or a variety of other creative sanctions.

QUID PRO QUO CONTRIBUTIONS

In business, there are reasonable limitations on business-related expenses such as meals and entertainment expenditures, sporting events and other forms of client development. The for-profit can spend large sums of money by treating the value of gifts as taxable income to the recipient, and then add the gross amount of the benefit(s), to cover tax withholdings. However, there is no requirement of public disclosure.

A CIL may entertain its benefactors, although there may be perceived constraints dealing with excessive entertainment. Disclosure may be required to major contributors. Imagine a hypothetical situation where Greenpeace lavished a major contributor with a trip to a foreign country, the sight of an environmental mission. This trip and associated costs could be questioned by the IRS and create a major exposure.

A business cannot deduct actual gifts in excess of $25, unless the recipient reports the excess as taxable income. Again, there is no public disclosure. Conversely, a CIL must disclose the value of any benefits, other than incidental benefits, which are received by contributors in exchange for donations. This is an example where scrutiny and disclosure requirements are higher for the CIL, and may adversely impact business opportunities.

UNRELATED BUSINESS INCOME TAX (UBIT)

When a CIL has created an income opportunity, it does not necessarily have an automatic need to set up a for-profit organization. When a new business develops, it is usually small enough that it can be handled without serious tax-related consequences within the confines of the NFP structure. This would correspond to the early stages of a business venture.

The IRS website at *http://www.irs.gov/charities/article/0,,id=96104,00.html* offers some discussion on the definition and determination of the UBIT. Generally, tax is assessed on gross revenues earned in an unrelated activity, minus deductions directly connected with the income, and minus indirect expenses, which are allocable between the exempt functions and the business activity. The tax is generally computed at a standard corporate rate, which may vary from 15% to 35% on net unrelated business income.

Voluntary compliance with this tax assessment has been declining. In 1997, the IRS collected approximately $486 million from UBIT voluntary assessments, compared to $173 million in 1998. This is significant in light of the increased number of NFPs over the same period. As a result, the IRS has warned that NFPs can expect audit inquiries of their in-house for-profit activities. From a practical viewpoint, the IRS has budget constraints of its own, which may prevent significant compliance testing.

IRC Sec. 513 (a) defines an unrelated trade or business as any trade or business **not substantially related** to the exercise or performance of the organization's exempt status. IRS Publication 598 goes to great lengths to try to define the term not substantially related. However, it does so by inference and example. For instance, a payment from a sponsor for an ad in a brochure may be deemed a qualified sponsorship payment, and exempt from the UBIT, if the sponsor receives no substantial benefit other than the use or acknowledgement of the sponsor's name or logo. However, if there is an endorsement of the sponsor's products or services, price information, inducements to purchase, sell or use the sponsor's products, the sponsorship may be deemed a paid advertisement and subject to UBIT. This concept can be an elusive trap to the entrepreneur within a CIL. Guidelines provide that income-producing activities, which are carried on by volunteers or which are not "carried on regularly" by the NFP, are exempt from UBIT.

Generally, certain other items are exempt from the UBIT tax, including:

- Dividends
- Interest
- Annuities
- Other investment income
- Royalties
- Rents from real property, but not personal property
- Gains and losses from the disposition of property, but not inventory or stock in trade, or property held for resale in the ordinary course of business

The concept of UBIT should not be automatically viewed as an impossible hurdle for the CIL, which is seeking to protect its tax-exempt status and enhance its economic viability. However, the officers and board members should be cognizant of the potential problems and address this issue as part of the overall business plan. **Further, guidance from qualified legal and accounting counsel is necessary and strongly recommended.**

The CIL and a related for-profit business should not overlook other incidences of tax exposure such as the assessment of a sales or use tax associated with the sale or purchase of goods and services not directly covered by the exemptions afforded by state and local law. Again, specific guidance should be secured by the CIL.

THE BUSINESS STRUCTURE AND LEGAL FORM

Armed with these decision-making tools, the CIL entrepreneur must determine the most favorable legal structure in which to grow the for-profit business.

A CIL typically could start a business as the equivalent of a **sole-proprietorship** by the fact that the development of a profitable concept arises from the normal activities and services provided by the CIL in the process of service delivery to its consumers. Unfortunately, this approach does not offer the goal of having the for-profit business as a separate legal entity. As a proprietorship, the CIL's assets would be exposed to all of the risks associated with the new business, and the tax exempt status of the CIL may be exposed. At the very least, an UBIT would be an issue. This approach is not recommended.

Risks of the new activity can be largely controlled through proper insurance coverage, the development of managerial controls and systems to monitor development, growth and profitability of the new activity, and accounting controls to identify the components of information that generate UBIT. In certain cases, it may be advisable for the new business to be segregated from the main focus of the CIL for legal liability. This can be done through a limited liability company (LLC), limiting the liability exposure of the CIL's other assets. Again, this will not protect the CIL from rules of UBIT, private inurement or general disclosure of the activity in the CIL's audited financial statements. However, it does provide a corporate-like protection from business creditors.

THE CIL "CONTROLLING" AN NFP

If the new business is an acceptable NFP activity, the CIL may isolate the activity within another newly formed NFP, with the lead or parent NFP overseeing the activity through a common leadership. However, the Boards of Directors should not be identical. For instance, a 501(c)(3) may own athletic equipment as part of its service of training athletes, but it may not be able to provide use of the equipment to outsiders who are volunteers. An opportunity may exist, with proper structure, for a social and recreation club, under 501(c) (7) to purchase and maintain equipment by dues-paying members, who provide volunteer services to the amateur athletes. In this case, the 501 (c) (3) may own, or work in parallel with the 501 (c) (7) without the potential allegations of private inurement or UBIT.

(This example is for discussion purposes and not intended to be all-inclusive).

THE CIL WITH A FOR-PROFIT C-CORPORATION SUBSIDIARY

In situations where a CIL owns a controlling interest in a for-profit (FP) corporation, an argument can be made that the FP is an alter ego of the CIL, and that the two should be combined for the purpose of determining the entity's tax-exempt status. However, barring fraudulent or sham transactions, where the parent is not involved in day-to-day activities of the FP, or where the officers and Boards of Directors are not identical, the IRS will respect the separate identities of the FP and NFP.

It is often beneficial to have income flow to the CIL-parent from the FP-subsidiary in a fashion that does not defeat the CIL's tax-exempt status. A way to do this is to measure shared costs for occupancy, staffing, equipment and supplies, with the FP reimbursing the CIL. Another methodology is for the CIL to lend start-up money, at appropriate rates of interest, to the FP. In certain cases, the FP may be licensed by the CIL to use its name, logo or acronym in selling products. This could result in a payment of a royalty to the CIL. Congress was aware that these approaches could generate an unfair tax-savings opportunity, and therefore implemented IRC Section 512(b)(3) to define these payments as UBIT income. Attempts are being made to exempt rents, royalties, and interest from UBIT when paid at fair market value. Exceptions deal with payments made by a FP subsidiary to its NFP, when these payments are not tax deductions to the FP, such as dividends in a C-Corporation. Another exception occurs when the NFP owns less than 50% of the FP stock, controlling interest.

THE CIL WITH AN S-CORPORATION SUBSIDIARY

The Small Business Job Protection Act of 1996 allows an NFP to be a stockholder in an S-Corporation. An S-Corporation pays no federal (and, in some cases state) income taxes. Instead, the S-Corporation earnings are attributable to the stockholder. The earnings of the S-Corporation, which are attributable to a tax-exempt organization, are automatically treated as UBIT income. The gain or loss on sale of the stock of the S-Corporation is also subject to UBIT.

THE CIL AS A PARTNER IN A PARTNERSHIP (INCLUDING LIMITED PARTNERSHIPS)

The IRS has historically taken a negative position on partnerships where a NFP is involved, except in cases where the NFP's role was strictly passive and not contrary to the prime objective of the NFP. A passive role would include the NFP being a limited partner in a partnership of an investment. The IRS reasons that the NFP, in partnering with FP entities, is using its efforts to the private inurement of its FP partners. As a result, such arrangements could result in automatic revocation of the NFP's tax-exempt status.

The current IRS position has softened slightly. A charitable organization will lose its tax-free status if it participates as a general partner in a limited partnership, unless the principal purpose of the partnership is the furtherance of the NFP's charitable purposes. Even if the limited partnership meets these criteria, the exemption from tax will be revoked if the NFP, as general partner, is not adequately insulated from the day-to-day management responsibilities and/or the limited partners receive an undue return. Bruce R. Hopkins provides a more thorough understanding of this technical topic, including its background and history in chapter 46 of The Law of Tax Exempt Organizations.

Joint ventures do not face the same tax scrutiny, because a joint venture is not a business activity carried on in a regular manner over a long period of time. However, the IRS will look to the nature of the underlying activity to determine whether the joint venture deviates from the NFP's prime objective or whether the private inurement rules are violated. If so, the tax-exempt status again can be lost. The best advice for a CIL is to avoid partnership structures until the IRS revises its position or rules, where the partnership purpose is not the same as the charitable purpose.

FINANCIAL STATEMENT AND DISCLOSURE CONSIDERATIONS

What discussion would be complete without including generally accepted accounting principles? The American Institute of Certified Public Accountants (AICPA), the Financial Accounting Standards Board (FASB) and a variety of other sources promulgate accounting rules. When a NFP reports information in financial statements, the information must meet certain minimum standards in order to be useful to readers. In the case of NFP's, the interested readers include the NFP's creditors, donors, would-be donors, the IRS, and in some cases, the Attorney General of the state.

When deciding on the form of your for-profit entity, be aware that disclosure rules with related parties are stringent. AICPA Statement on Auditing Standard No. 6 effectively describes related parties as anyone having a significant direct or indirect interest or degree of control in an organization. In the case of a FP subsidiary, all funds transferred between the FP and NFP must be disclosed, as well as the intended nature of the transactions. Year-end balances due to and from the entities, as well as the cause of the relationship require disclosure. The FASB is working on a project to determine whether a NFP should issue combined financial statements with a FP subsidiary in order to be meaningful.

The relevance of these issues would be:

- Combined financial statements could confirm a view that disproportionate efforts of the NFP are not program-related in the FP.
- The detail of disclosure, combined with information available from the annual Federal Form 990, could provide sufficient data to competitors of the FP business subsidiary, reducing the FP's ability to compete.

These considerations may be factors impacting the CIL entrepreneur and should not be overlooked in the planning process.

CREDITS AND OTHER REFERENCE SOURCES

Julie Floch, CPA, Partner at Richard A. Eisner & Company, LLP, New York, New York. (212-355-1700) Technical Advisor

Hopkins. B. R. (n.d.) The Law of Tax-Exempt Organizations, 6th Ed., ISBN: 0-471-47122-4, July 2004

The PPC Nonprofit Update: Practitioners Publishing Company, Fort Worth, Texas, monthly newsletter

National Center for Nonprofit Boards, Washington, D.C. (202-452-6262)

Internal Revenue Service Website http://www.irs.ustreas.gov

John Oehler, CPA, Lumsden McCormick, LLP, Buffalo, New York (716-856-3300)

NYS Small Business Development Center
THE STATE UNIVERSITY of NEW YORK

BEING ENTREPRENEURIAL

A BUSINESS GUIDE FOR CILS

New York State Small Business Development Center
and the The CIL Management Center of the
Western New York Independent Living Project, Inc.