Citrus Business Management Programme

Module 4

Launch and Grow your Business

Learner Guide

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Contents

Directions

Unit Standard Information

Finance a new venture

SAQA US ID	**UNIT STANDARD TITLE**			
114584	Finance a new venture			
ORIGINATOR				
SGB Generic Management				
PRIMARY OR DELEGATED QUALITY ASSURANCE FUNCTIONARY				
-				
FIELD			**SUBFIELD**	
Field 03 - Business, Commerce and Management Studies			Generic Management	
ABET BAND	**UNIT STANDARD TYPE**	**PRE-2009 NQF LEVEL**	**NQF LEVEL**	**CREDITS**
Undefined	Regular-Fundamental	Level 4	NQF Level 04	5
REGISTRATION STATUS		**REGISTRATION START DATE**	**REGISTRATION END DATE**	**SAQA DECISION NUMBER**
Reregistered		2015-07-01	2018-06-30	SAQA 10105/14
LAST DATE FOR ENROLMENT		**LAST DATE FOR ACHIEVEMENT**		
2019-06-30		2022-06-30		

In all of the tables in this document, both the pre-2009 NQF Level and the NQF Level is shown. In the text (purpose statements, qualification rules, etc), any references to NQF Levels are to the pre-2009 levels unless specifically stated otherwise.

This unit standard does not replace any other unit standard and is not replaced by any other unit standard.

PURPOSE OF THE UNIT STANDARD

This Unit standard is intended for learners who need to make decisions and recommendations about financing options for a new venture.

The qualifying learner will be able to:

- Determine the capital requirements of the new venture.
- Identify and compare all short term and long term funding options and services offered by the finance industry for new ventures.
- Compile personal income and expenditure and assets and liabilities statements.
- Identify the requirements and processes to access the selected financing option for the new venture.
- Identify alternative sources to secure finance for a new venture.

LEARNING ASSUMED TO BE IN PLACE AND RECOGNITION OF PRIOR LEARNING

Learners accessing this qualification should be competent in Computer Literacy, mathematical Literacy and Communication at NQF Level 4 or equivalent.

UNIT STANDARD RANGE

- Funding requirements and capital structure include working, fixed, debt and equity capital.
- Banking and financial institutions may include but are not limited to registered banks, merchant banks, and micro-finance institutions.
- Alternative funding options.

Negotiate an agreement or deal in an authentic work situation

SAQA US ID	**UNIT STANDARD TITLE**			
13948	Negotiate an agreement or deal in an authentic work situation			
ORIGINATOR				
SGB Generic Management				
PRIMARY OR DELEGATED QUALITY ASSURANCE FUNCTIONARY				
-				
FIELD			**SUBFIELD**	
Field 03 - Business, Commerce and Management Studies			Generic Management	
ABET BAND	**UNIT STANDARD TYPE**	**PRE-2009 NQF LEVEL**	**NQF LEVEL**	**CREDITS**
Undefined	Regular-Fundamental	Level 4	NQF Level 04	5
REGISTRATION STATUS		**REGISTRATION START DATE**	**REGISTRATION END DATE**	**SAQA DECISION NUMBER**
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This unit standard does not replace any other unit standard and is not replaced by any other unit standard.

PURPOSE OF THE UNIT STANDARD

This unit standard is intended as part of a qualification for managers of small businesses and junior managers of business units in larger organisations. The term business unit in this unit standard implies a small business, cost centre, section or department. The unit standard could be useful for any employee who is involved in situations where negotiation skills are required.

Junior managers include, but are not limited to team leaders, supervisors, first line managers and section heads. The position or term is used to describe the first level of management in an organisation at which an employee has other employees reporting to him/her.

The qualifying learner is capable of:

- Explaining the need for negotiation skills in business.
- Explaining the steps in the negotiation process.
- Applying the steps in the negotiation process to an authentic situation.
- Explaining strategies that could be used in negotiation.

LEARNING ASSUMED TO BE IN PLACE AND RECOGNITION OF PRIOR LEARNING

There is open access to this unit standard.

Learners should be competent in Communication and Mathematical Literacy at NQF Level 3.

UNIT STANDARD RANGE

- For the purpose of this unit standard the term business unit is used to mean a cost center, department or small business.
- Steps in the negotiation process include preparation, presentation, probing, bargaining and closing.
- Different types of closure include, but are not limited to, concession close, summary close, adjournment close, or-else close and either-or close.

Interpret and use information from texts

SAQA US ID	**UNIT STANDARD TITLE**			
119457	Interpret and use information from texts			
ORIGINATOR				
SGB GET/FET Language and Communication				
PRIMARY OR DELEGATED QUALITY ASSURANCE FUNCTIONARY				
-				
FIELD			**SUBFIELD**	
Field 04 - Communication Studies and Language			Language	
ABET BAND	**UNIT STANDARD TYPE**	**PRE-2009 NQF LEVEL**	**NQF LEVEL**	**CREDITS**
Undefined	Regular-Fundamental	Level 3	NQF Level 03	5
REGISTRATION STATUS		**REGISTRATION START DATE**	**REGISTRATION END DATE**	**SAQA DECISION NUMBER**
Reregistered		2015-07-01	2018-06-30	SAQA 10105/14
LAST DATE FOR ENROLMENT		**LAST DATE FOR ACHIEVEMENT**		
2019-06-30		2022-06-30		

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This unit standard replaces:

US ID	**Unit Standard Title**	**Pre-2009 NQF Level**	**NQF Level**	**Credits**	**Replacement Status**
8969	Interpret and use information from texts	Level 3	NQF Level 03	5	Complete

PURPOSE OF THE UNIT STANDARD

Learners at this level read and view a range of texts. People credited with this unit standard are able to read and view a variety of text types with understanding and to justify their views and responses by reference to detailed evidence from texts. They are also able to evaluate the effectiveness of different texts for different audiences and purposes by using a set of criteria for analysis.

Learners credited with this unit standard are able to:

- Use a range of reading and viewing strategies to understand the literal meaning of specific texts
- Use strategies for extracting implicit messages in texts
- Respond to selected texts in a manner appropriate to the context
- Explore and explain how language structures and features may influence a reader/viewer

LEARNING ASSUMED TO BE IN PLACE AND RECOGNITION OF PRIOR LEARNING

The credit calculation is based on the assumption that learners are already competent in terms of the following outcomes or areas of learning when starting to learn towards this unit standard: Level 2 unit standards entitled Access and use information from texts.

UNIT STANDARD RANGE

A variety of written and/or signed/visual texts used in socio-cultural, learning and workplace contexts.

Specific range statements are provided in the body of the unit standard where they apply to particular specific outcomes or assessment criteria.

Using the Learner Guide

This learning material has been developed to assist the learner wishing to complete this unit standard. The guide contains all necessary learning to ensure that the learner will attain the competencies required by the unit standard.

The learner guide is accompanied by formative and summative portfolio of evidence (PoE) guides. Please ensure that you have access to these guides as well. The learner guide was designed to be used by a learner during the presentation of a skills programme based on the unit standard and to be kept afterwards by the learner for reference purposes. The PoE guides were designed to be completed during and after the presentation of the skills programme and forms part of the assessment process.

Background Information

The main theme of this module is to guide entrepreneurs when obtaining finance for their business and to assist them in understanding the art and discipline of contract negotiation

The module will cover aspects such as:

- Financing a new business.
- Step-by-step through negotiating deals and contracts.
- Critical reading and comprehensions skills required for understanding financial and contractual documents.

This module contributes to the exit level outcome and associated criteria:

3. Demonstrate an understanding of basic economics within a market economy.
   - 3.1. An understanding is demonstrated of new venture financing sources and opportunities.
   - 3.2. An understanding is demonstrated of the principles of micro and macroeconomics.

3.3. Potential threats and opportunities within the economic environment are identified for future business decision making.

3.4. An understanding is demonstrated of business competitiveness.

Range: Business competitiveness includes but is not limited to factors such as inflation, exchange rates, interest rates, economic indicators and competition.

This module comprises of 3 unit standards and attracts 15 credits.

This module is aligned to unit standards:

Finance a new business	114584	Finance a new venture	C	4	5
Negotiation	13948	Negotiate an agreement or deal in an authentic work situation	C	4	5
Critical reading and comprehension	119457	Interpret and use information from texts	C	4	5

Learning Outcomes

This learner guide has the following learning outcomes:

Section 1 –Business Finance

1. Determine the capital requirements of the new venture.
   1.1. Funding requirements and capital structure are identified and analysed for the new venture.
   1.2. Realistic fixed asset requirements are determined for the new venture.
   1.3. Pre-operating costs are identified and calculated to an exact value.
   1.4. Monthly operating costs - including a cash flow statement - are compiled for the new venture.
   1.5. The financial viability of the proposed new venture is assessed and estimation made of the break-even point.
2. Identify and compare funding options and services offered by the finance industry for new ventures.
   2.1. An extensive list of financial institutions offering funding for new ventures is compiled with a view to selecting the one best suited to the particular venture.
   2.2. The various funding packages (products) appropriate for a new venture are investigated and compared in terms of own venture needs.
   2.3. The cost of the various funding options is compared to determine suitability for own venture's business structure.
   2.4. Short-term and long-term advantages and disadvantages of the various funding options are considered and discussed in the context of own business and a decision made as to the most suitable.
3. Compile personal income and expenditure and assets and liabilities statements.
   3.1. Personal income and expenditure statements are prepared for oneself based on one's own financial situation over the past year.
   3.2. The situations when an assets and liabilities statement is required are listed and an indication is given of the advantages of keeping such records.
4. Identify the requirements and processes to obtain the selected financing option for the new venture.
   4.1. Collateral requirements for accessing funding are identified to determine if they can be met.
   4.2. The new venture proposals are assessed in terms of available collateral.
   4.3. The information and backup documentation needed to process application for funding is collected and used to complete the application.
   4.4. A financing option is chosen that is consistent with the business plan in terms of profit objectives and return on capital.
   4.5. Laws, regulations, rules and procedures covering the provision and use of financial services are observed to ensure compliance.
5. Identify alternative sources to secure finance for a new venture.

5.1. The difference between debt (loans) and equity (owner's capital) is explained with reference to the new venture.

5.2. Problems faced in obtaining finance for the new venture are identified with a view to overcoming them.

5.3. Alternative sources of equity are investigated for the new venture.

5.4. Government and non-governmental schemes for new venture creation are investigated and analysed and an explanation given of their advantages and disadvantages for the new venture.

5.5. The option of leasing as a method of reducing start-up capital is considered for own venture.

5.6. The repayments and interest rates of the alternative options are considered and compared to those of the financial institutions to make informed decisions.

Section 2 – Contract Negotiation

1. Explain the need for negotiation skills in business.

   1.1. Reasons why managers need negotiation skills are indicated with reference to the changing nature of the workplace and democratisation.

   1.2. The kind of decisions that lower level managers are required to negotiate is identified with reference to the management structure of the organisation and labour legislation.

2. Explain the steps in the negotiation process.

   2.1. The steps used in negotiation are named and explained in terms of what is entailed at each step.

   2.2. Reasons why negotiations fail are listed and an indication is given of what negotiators can do to facilitate a mutually satisfactory solution.

   2.3. The abilities needed by skilled negotiators are identified and an indication is given of how each ability can contribute to the success or failure of a negotiation and at what stage of the negotiation each skill may be required.

3. Apply the steps in the negotiation process to an authentic work situation.

   3.1. The concepts of "favoured outcome", "settlement point" and "point beyond which you cannot get" are explained for a selected scenario.

   3.2. The disadvantages to each party of each position are considered prior to meeting.

   3.3. Possible points that the other party might raise are anticipated and a possible response to each identified point is considered for the selected scenario.

   3.4. A proposal is presented and a clear indication is given of what is and what is not on the table for a selected scenario.

   3.5. A point-by-point summary of the proposal is compiled to ensure that both parties have a common understanding of the nature and extent of the proposal.

   3.6. Questions are asked to build common ground and establish the existence of any hidden agendas.

   3.7. Shared interests, opportunities for cooperation and common principles are identified in order to facilitate negotiation.

   3.8. A position is amended without sacrificing fundamental interests for a selected scenario.

3.9. Questions are asked for clarification and explanation.

3.10. Questions are asked to test understanding and to summarise understanding of a position.

3.11. Demands of the other party are analysed and a concession is proposed for a selected scenario.

3.12. The negotiation is closed for a selected scenario.

4. Explain strategies that could be used in negotiation.

4.1. Tactics that can be used to delay a negotiation are described with examples.

4.2. Methods that can be used to break a deadlock are explained with examples.

4.3. Different types of closure are identified and an indication is given of when each is suitable.

Section 3 – Critical Reading and Comprehension of Business Documents

1. Use a range of reading and / or viewing strategies to understand the literal meaning of specific texts.

1.1. Unfamiliar words / signs are identified. Their meanings are correctly determined by using knowledge of syntax, word-attack skills / sign parameter / analysis skills, and contextual clues.

1.2. Different options for the meanings of ambiguous words are tested, and selected meanings are correct in relation to the context.

1.3. Main ideas are separated from supporting evidence and paraphrased or summarised.

1.4. The purpose of visual and / or graphic representations in texts are recognised and explained.

1.5. Features of visual texts are explained in relation to the way they impact on meaning.

2. Use strategies for extracting implicit messages in texts.

2.1. Source of text is identified and discussed in terms of reliability and possible bias.

2.2. Attitudes, beliefs, and intentions are explored in order to determine the point of view expressed either directly or indirectly.

2.3. Techniques are explored and explained in terms of purpose and audience.

3. Respond to selected texts in a manner appropriate to the context.

3.1. Instructions and requests are acted upon.

3.2. Text-type, format, and register used are on the appropriate level of formality.

4. Explore and explain how language structures and features may influence a reader / viewer.

4.1. The choice of words / signs, language usage, symbols, pictures and tone / sign size and pace is described in terms of how a point of view is shaped or supported.

Note that the following critical outcomes are also developed and assessed in an integrated manner, as part of this learning module:

1. Identifying
2. Collecting

3. Communicating
4. Science and Technology

Keep these learning goals in mind throughout your work related to this module.

There is an opportunity for self-assessment and a progress check at the end of this learner guide. Make time to assess yourself and ask the facilitator, assessor, your workplace mentor or coach for help if you are unsure of the answers.

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Section 1: Business Finance

Learning Goals and Pathways

In order to run a successful business, you will need capital.

This section will help you to work through a step-by-step methodology of obtaining business finance.

This section is presented in the first 4 chapters of the guide. Note that there are also a number of annexures at the end of section 1, which may be useful tools to help you in the process of seeking and obtaining business finance.

The learning goals for this module include:

1. To determine the capital requirements of your business.
2. To identify and compare all short-term and long-term funding options and services offered by the finance industry for new business ventures.
3. To compile personal income and expenditure and assets and liabilities statements.
4. Identify the requirements and processes to access finance for your business.
5. Identify alternative sources to secure finance for a new venture.

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Chapter 1
Capital Requirements

information

Please note

In the glossary, you will find a number of useful financial terms and definitions. Please consult this guide every time you come across a term you do not understand.

Introduction

Citrus originates from the subtropical regions of south-east Asia. In the wild, citrus trees in these regions produce fruit all year round, and the fruit is small, poorly coloured and blemished. In the absence of effective production practices, citrus trees do not produce fruit suitable for the market. At this point of your entrepreneurial development, your head must be bursting with new business ideas. However, most business ideas need capital to change that particular idea into a reality.

Thus, action needs to be taken to look for funding for that particular business. Most times you may identify a significant funding need that cannot be sourced from your own resources (which may include those of your relatives, friends, colleagues, credit cards, local bank manager and so on) or from the cash flow of another business that you own. This will result in the need to raise external finance in the form of equity (your own sources) or loans, or potentially by a combination of both equity and loans.

Cost Classification

Every new business has associated start-up costs or capital requirements. Costs are any financial input into a business. As you know, most businesses require inputs, equipment, infrastructure, and safety. Each of these inputs has a financial implication.

Costs can be differentiated into fixed costs and variable costs, and indirect costs and direct costs. A cost in a business is the total money, time, and resources associated with a purchase or activity. In order to produce a product in an enterprise, total costs of that production include fixed and variable costs, direct costs and indirect costs.

Fixed costs are those costs in a business that do not, in the short-term, vary with the number of goods produced or sales levels. Examples of fixed costs are rent on property, rent on equipment, insurance or interest expenses and depreciation. Fixed costs do not change, regardless of the number of products produced and sold, they remain the same.

Variable costs vary depending on the production levels of the enterprise. The more products made, the more materials are used. The more products made, the more labour would be used. Thus, the costs of these inputs would increase. Examples of variable costs in manufacturing in a craft production business may include paint, leather, cotton, fabric and labour.

Costs can also be categorised into indirect costs and direct costs:

Indirect (Overhead) Costs

Indirect costs are those costs incurred by the business which cannot be directly associated with any particular product or service which that business provides for its customers. These costs are called "indirect" costs because they are different to "direct" costs that can be directly attributed to a particular end product or service of the business. This principle is the same for all types of business in all sectors of operation namely private or public sectors.

The same principle applies to indirect costs incurred in each functional area of the business being production, selling, distribution and general administration.

Examples of indirect overheads are things such as rent, utilities (water and lights), building maintenance and renovation, labour and materials and insurance.

Direct Costs

Direct costs include all those costs that are incurred in the direct production of the product. For example, if a company is involved in growing tomatoes then the direct costs include the costs of labour, seed, fertiliser and water. Direct costs include materials and other expenses specifically incurred to produce a specific product or provide a certain service.

Capital Requirements

The total capital requirement, also known as total project cost or total investment requirements, is composed of three items: fixed assets, pre-operating expenses, and working capital.

To calculate the total capital requirements, add the following:

- Fixed assets
- Pre-operating expenses
- Working capital

Fixed Assets

Fixed asset costs are all costs of land and improvements, building, machinery, furniture and fixtures. Fixed assets can be financed in different ways. Financing may be required to purchase fixed assets and you may also need financing to pay start-up operational costs. Let us look at these two different needs.

definition

Fixed asset

Also known as a non-current asset or as property, plant, and equipment (PP&E).

It is a term used in accounting for assets and property which cannot easily be converted into cash. In most cases, only tangible assets (those which you can physically touch or see) are referred to as fixed.

Also, a fixed / non-current asset can also be defined as an asset not directly sold to a firm's consumers / end-users.

This can be compared with current assets such as cash or bank accounts, which are described as liquid assets. As an example, a baking firm's current assets would be its inventory (in this case, flour, yeast), the value of sales owed to the firm via credit (such as debtors or accounts receivable), and cash held in the bank.

Its non-current assets would be the oven used to bake bread, motor vehicles used to transport deliveries, and cash registers used to handle cash payments. Each aforementioned non-current asset is not sold directly to consumers. Fixed assets are items of value which the organisation has bought and will use for an extended period of time. Fixed assets normally include items such as land and buildings, motor vehicles, furniture, office equipment, computers, fixtures and fittings, and plant and machinery.

Pre-Operating Expenses

Pre-operating costs are expenditures made in a period that precedes operation, to establish a business.

These costs may be postponed for payment to a later stage in limited circumstances. Pre-operating costs are costs that are deferred until the related assets are ready for revenue service at which time the costs are charged to operations. Thus, before starting your business there may be some things that you need to pay. These items may be included in your start-up capital requirements.

example

Pre-operating costs

Let us take a look at the example of the pre-operating costs for the small fitness centre for Mr X.

Rental deposit (1 month)	R 4,500
Electricity deposit (1 month)	R 2,400
Rent in advance	R 4,500
Telephone connection plus ADSL	R 1,100
Salaries	R 13,130
Branding and design	R 200
Advertising	R 1,500
Staff uniforms	R 1,100
Consumables	R 1,500
Total	**R 29,930**

Working Capital

Working capital is the amount of money permanently needed in cash or in kind to keep the business operating while it is awaiting full payment of goods / services sold to customers.

When you are in business, it is important to know how to spend the money that your business has in order to get a clear indication of where the money is going. You need to know all the costs of the business so that you can see whether your business is going in the right direction. Depending on your type of business, costs can be categorised into variable costs or fixed costs. Some of these costs may need to be paid daily, weekly or monthly. When planning the short- or long-term funding requirements of a business, it is more important to forecast the likely cash requirements than to project profitability. Calculating the working capital or operating costs of your business allows you to determine how much money is needed to keep the business operational.

Working capital can be calculated by adding five factors:

- The cost of maximum raw material stocks that will have to be stored to ensure continuous production. In some cases, this might be three to six months' worth, whereas in other cases only one or two weeks' worth may be needed. To determine the cost of raw material stocks, simply multiply the quantity needed by its purchase price.
- The cost of finished goods which will be kept in stock awaiting distribution to the customers. To determine the cost of finished goods stock, multiply the number of units to be kept by the unit production cost.
- The cost of work-in-process which is on the factory floor but has not yet been converted into a final product or finished goods. To determine the cost if work-in-process, first estimate the number of days it takes to convert stock, then multiply this by the daily production level, then multiply the figure obtained by the unit production cost. Finally, divide the figure by 2.
- The cost of goods already distributed to customers but which have not yet been paid (accounts receivable). To determine the cost of goods already distributed but not yet paid for, estimate the quantity that will be given on credit and multiply this number by the production cost.
- The amount of ready cash needed to pay workers and overheads. To determine the amount of cash needed in the business, add the monthly labour cost and overheads to the monthly marketing expenses and the administration expenses.

Add these five cost elements together to arrive at the total working capital requirements.

Cash Flow

Whilst profit (the difference between sales and costs within a specified period) is a vital indicator of the performance of a business, the generation of a profit does not necessarily guarantee its development or even its survival. It is also important to keep in mind that more businesses fail due to poor cash flow than for want of profit.

Developing a cash flow plan assists you to see how you could make your business idea work. When designing a cash flow plan you are able to go back and make decisions about what costs to cut and which inputs to purchase at a later stage. It also helps you to set sales targets. Your marketing plan (and its costs) can then be accurately targeted to reach a certain sales goal.

It is extremely helpful to use a computer programme such as Excel which can automatically do the calculations for you. If you are not familiar with Excel, get familiar with it! Ask your facilitator to set aside 1 hour to assist you to use this computer software package.

A cash flow statement shows the sources (inflow) and application (outflow) of the cash in a business during the year. See an example below.

example

Cash flow statement

Cash Inflow (Income)	
1. Cash sales	R 201,600
2. Collection of accounts receivable	R 184,800
1+2. Total Cash Inflow	**R 386,400**
Cash Outflow (Expenses)	
3. Direct materials	R 312,840
4. Direct labour	R 19,200
5. Operational overheads	R 25,200
6. Inventory of material	R 26,070
7. Inventory of work in process	R 750
8. Inventory of finished goods	R 15,000
9. Marketing expenses	R 600
10. Administrative expenses	R 34,400
11. Interest payment	R 7,002
12. Loan repayment	R 14,004
3+4+5+6+7+8+9+10+11+12. Total Cash Outflow	**R 424,066**
13. Net cash flow (outflow)	(R 37,666)
14. Cash balance beginning	R 61,020
Cash Balance Ending	**R 23,354**

In this example, this business would not have had a positive cash flow at the end of the year if it did not have item 14. A cash balance at the beginning of the year. Do you see the net cash flow (item 13. was actually negative)?

This example shows an annual cash flow result. However, let's look at it from an annual planning perspective which is very useful.

In most cases, the main sources of cash inflows to a business are receipts from sales, increases in bank loans, proceeds of share issues and asset disposals, and other income such as interest earned.

Cash outflows include payments to suppliers and staff, capital and interest repayments for loans, dividends, taxation and capital expenditure.

Net cash flow is the difference between the inflows and outflows within a given period.

A projected cumulative positive net cash flow over several periods highlights the capacity of a business to generate surplus cash and, conversely, a cumulative negative cash flow indicates the amount of additional cash required to sustain the business.

Cash flow planning entails forecasting and tabulating all significant cash inflows relating to sales, new loans, interest received, and then analysing in detail the timing of expected payments relating to suppliers, wages, other expenses, capital expenditure, loan repayments, dividends, tax, and interest payments.

The difference between the cash in- and outflows within a given period indicates the net cash flow. When this net cash flow is added to or subtracted from opening bank balances, any likely short-term bank funding requirements can be ascertained.

Break-Even Point (BEP)

A new or start-up business may find it difficult to make a profit from the beginning of operations. However, the business should at least break even from the beginning. This means that enough income is generated to cover ALL the costs (including salaries) from the beginning. The break-even point (BEP) is the point at which costs or expenses and revenue are equal: there is no net loss or gain, and one has broken even. Therefore there has not been a profit generated or a loss incurred.

Three kinds of break-even points (BEP) are commonly referred to, namely:

- **BEP sales (money)** is the sales value at which no profit or loss is incurred by the business.
- **BEP production (volume)** is the level (volume or quantity) of production at which no profit or no loss is incurred by the business. Production above this level will result in a profit and production below this level will result in a loss.
- **BEP percentage** is the percentage of sales or production at which the business makes neither profit nor loss. Production above this level will result in a profit and production below this level will result in a loss.

You need to know the sales, direct and indirect costs of your business in order to calculate the BEP.

To determine BEP annual sales, multiply annual sales found in the income statement by the annual fixed costs.

To determine BEP production volume, divide BEP sales by the unit selling price (USP). Another method is to divide annual fixed costs by unit price less unit variable cost, also known as contribution margin, that is, what is left to cover fixed costs and profit. At BEP, the contribution margin can only cover fixed costs, not profit.

To determine BEP percentage on yearly sales, multiply the yearly fixed costs by 100, divided by annual sales minus the variable costs.

practical

Complete the following formative assessment:

F114584.1 – Team Research Worksheet

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Chapter 2
Funding Options and Services

Financial Institutions

Once you have planned your operations - what capital requirements you will need for start-up, direct costs, indirect costs, fixed costs and variable costs and put all of these into a cash flow plan - you will have a good, clear indication of your financial start-up and operating requirements.

If you do not have these finances yourself (equity), and you see (from your cash flow planning) that you will not be able to generate the required capital to maintain the business until it reaches profitability (but you see that the business could become profitable at a point in the future – perhaps once loans have been repaid) then you may need to consider looking for finance from another institution.

Is a loan needed? What will the equity contribution be of the entrepreneur? In addition, how much do you need to lend?

How the total capital requirement is going to be sourced is called the financial plan. Bankers want to know the sources and what different project cost components are being funded by the various financial sources.

The entrepreneur is almost expected to make an equity (owner's capital) contribution to the project. For example, if the project costs R 50,000, the bank may require you to put up at least R 10,000, or 20%. The R 10,000 constitutes the owner's equity.

To arrive at the amount of loan needed, subtract the equity from the total capital requirements. List this as follows:

Source	**Amount**	**Use**
Equity	R 27,000	Working Capital
Loan	R 70,020	Machinery
Capital Requirements	**R 97,020**	

It is also possible to borrow from other sources like family members, friends, raw material and equipment suppliers in addition to banks. Your financing plan (although given here as a very simplified matter) may look like the one above.

Every financial institution that lends you money incurs a cost to you. Because of this cost, careful research into financial institutions and their advantages and disadvantages needs to be undertaken. Do not make the mistake of taking the first financial product that you are offered. Get all the details you need, but then move on to the next financial institution and compare the offer.

Some examples that you may not have considered include:

- National Youth Development Agency (previously known as Umsobomvu Youth Fund)
- National Empowerment Fund (NEF)
- Department of Economic Development

- Commercial banks such as ABSA, Standard Bank, FNB, Nedbank
- Department of Trade and Industry
- Isivande Women's Fund
- Small Enterprise Finance Agency (SEFA)
- Industrial Development Corporation (IDC)

Financial Products

Most people have a feeling that it is not an easy process to access funding. This may be caused by a lack of information and lack of skills to use that information to the benefit of your potential business. There are four common types of financing available to individuals or entrepreneurs when they are thinking of starting or expanding a business.

These are:

- Private loans from family, friends or other interested parties
- Bank loans in the form of either overdrafts or fixed period personal or business loans
- Term financing such as hire purchase or leasing
- Private- or quasi-equity investment

Private Loans

In the case of private loans, entrepreneurs often find themselves limited by the amount of money a family member or friend has available.

These loans are also often unstructured, leaving the entrepreneur open to uncertainty and even abuse, or there is an expectation that they will be paid back within a very limited time period and / or at a rate of interest higher than that available through a financial institution.

Many small businesses are started with private loans, but a major inhibitor for this source of funding can be the requirements by the family member or friend providing the funds to be "hands-on" and even "hands-in" involved in the business.

Bank Loans and Term Financing

In the case of overdrafts, bank loans and term financing, the amount available to the entrepreneur is limited by the security he or she is able to offer against the loan.

This usually takes the form of property, fixed assets, and insurance policies, or in the case of term financing of moveable assets (for example vehicles).

Also, when making use of these forms of financing, the financial institution in question has no vested interest in the business's ultimate success or failure and so provides no ongoing business support.

The collateral and deposit (or own contribution) requirements often make this an option that is out of reach of many aspiring entrepreneurs.

Equity Investments

Private and quasi-equity investments are made on the basis of two main criteria. Firstly, the potential for success in the market sector as contained in the applicant's business plan and, secondly, the skills and business management abilities of the entrepreneur or entrepreneurs.

Quasi-equity investments are not made on the basis of security. Funders usually assess the entrepreneurs, examine the viability of the business and consider the portion of the required investment the entrepreneur may or may not have to contribute to the venture, either in the form of cash or assets.

This enables SMMEs (run by solid entrepreneurs) with limited security or own contributions, but with a viable business plan, to obtain financing for their ventures.

The funder has a vested interest in the success of the business venture since it will be sharing in the profits of the business, depending on the structure of the funding transaction.

In a certain sense, this type of finance can be similar to the funding provided by a family member or friend, but with the difference that the investor will be an outside professional and disassociated entity. Before acquiring finance for a business, an entrepreneur should carefully assess his funding needs, what he or she has to offer in terms of own funds and collateral and then target the best funder based on these facts.

Determining Finance Option Costs

It is important to consider business financing that you will be able to pay back in a reasonable amount of time. Remember, the longer you take to repay a loan, the higher the cost of that loan. Paying off more than you need to monthly, or paying off the loan before the due date, will hold considerable benefits for you as regards costs.

Never take on a loan product that you will find difficult to repay. This leads to constant stress in the business and will impede the growth of your business (all your income generated will need to be used to repay the loan leading to dissatisfaction as an entrepreneur). Therefore, make comparisons between the various packages on offer. This will help you to make an informed decision that will help you to grow and sustain your business.

Advantages and Disadvantages of Funding Options

Every financial product has its advantages and disadvantages. Let us consider what these may be:

Long-Term Finance

- Long-term finance is used for purchasing of commercial / industrial / residential property.
- The term of the loan will normally vary between 10 -15 years (commercial and industrial) and 20 years for residential property.
- The enterprise borrows the money at a fixed price (interest) and the loan must be repaid over a period agreed with the bank.
- A bond for building is a familiar type of long-term loan from a bank.
- Additional repayments into a long-term loan can considerably reduce the cost of these loans.
- Interest rates are usually lower than other types of financing.

- The only way of paying up this type of loan is by paying it off or by selling the asset purchased with the loan at a profit.
- This type of loan allows entrepreneurs to attain fixed assets, which, if sold at a profit (which is usually the case with property), can be used to finance a second purchase or further business growth.
- These types of loans can often be repaid and the amount repaid can again be utilised (before the due date).

Medium-Term Finance

- This is a form of financing that makes capital available over a period of between one (1) and five (5) years.
- Examples of these are financial leases, rental agreements, and instalment credit.
- Interest rates are usually medium to high.
- Collateral or detailed financial performance records is often required.

Short-Term Finance

- This enables SMMEs - run by solid entrepreneurs - with limited security or own contributions, but with a viable business plan, to obtain financing for their ventures.
- This is a form of capital that is normally available for a period of one (1) year or less. Examples of short-term finance are overdraft facilities, supplier credit, and consumer credit.
- A disadvantage of borrowing funds from lending institutions on a short-term basis is that they might be apprehensive about lending a sum of money to a new entrepreneur especially if they do not have business experience.
- If the entrepreneur defaults on payments he / she will be putting the business relationship at risk.
- Equity capital, venture capitalists and "angel investors" are popular sources of small business funding. These forms of finance can be long, medium or short-term financing. A brilliant management team and rapid future growth plan are some of the prerequisites of obtaining equity capital from business investors. One downside is that entrepreneurs may have to give up a percentage of ownership of their company to accommodate the business investor demands.

practical

Complete the following formative assessment:

F114584.2 – Team Research Worksheet and Class Presentation

Chapter 3
Financial Reports

Income Statement

To access financial products from financial institutions requires that you provide evidence to them that you will be able to service (pay off) your loan. How do banks determine whether you are able to repay the loan? You need to provide them with a personal income and expenditure statement or in the case of a business, a profit and loss statement.

These statements show the financial institution that you are liquid (not overly in debt), that you have excess income that you could use to repay the loan (but that excess is not enough to cover the "bulk" costs you are now contemplating to start or expand a small business).

Personal income and expenditure statements also demonstrate that you keep records of your income and expenses. This is an indication that you practice financial planning, that you are organised and that you know what is going on in your personal finances.

Do not be fooled! The more accurate and complete your income and expenditure statement, the more likely the bank will be to grant you a loan. Your well-completed income and expenditure statement tells the bank a lot about you as an entrepreneur. Remember, the banks work with these forms every day and if you have left something out to make it look like you are more liquid than you are, they will probably notice it and ask you whether you have forgotten that item off your statement (also have a look at – and use – the Standard Bank Income and Expenditure Statement attached as Appendix F).

A profit and loss statement measures the performance of a company for a period. Performance is measured by income earned, less expenses incurred. If you are in business it is necessary to develop financial statements. You have money coming in and you have money going out. You have things that you own and things that you owe.

Let us look at the data requirements for a business profit and loss statement.

Start with sales, which are derived from multiplying the unit-selling price by the volume of expected sales during the year. From the annual sales revenue figure, gradually, subtract all the yearly expenses, such as raw material cost, labour cost, overheads, marketing cost, administrative cost, and finance cost.

If you borrow money from a funder, the latter would require you to project your profit and loss statement corresponding to the life of the loan. That is if you intend to pay the loan in five years, the bank will ask you to project your figures for five years.

It does not matter whether you earn a lot, or earn a little if you want to be successful in terms of utilising your income, you need to draw up an income and expenditure statement for a certain period in order to keep track of how the income you receive is spent.

Some people want to be rich but they do not want to see how they use their income. Most of them are scared to find out that they are not spending wisely. However, if you want your financial situation to change, you must do something to change it. One way to change your financial situation is to know exactly where you are financially. It will make it easier to chart a course to the financial position you would like to be.

Filling in an income and expenditure statement (or in the case of a business, a profit and loss statement) is a normal and common step when applying for any type of financial service.

You do not only complete such a form in once, you fill it in every time you apply for a financial product!

example

Income statement

Let us look at an example of a Profit and Loss Statement (one year):

Sales (20kg per day x 20 days per month x 12 months x R14 (unit selling price))	R 403,200
Less:	
Raw materials (R 26,070 x 12 months)	R 312,840
Labour (R 1,600 x 12 months)	R 19,200
Overheads (R 2,333 x 12 months)	R 28,000
	R 360,040
Gross Profit	**R 43,160**
Less:	
Marketing and administration (R50 + R500 x 12 months)	R 6,600
Operating Profit	**R 36,560**
Less:	
Finance costs	R 7,002
Net Profit Before Tax	**R 29,558**

Balance Sheet

A balance sheet is also called the statement of assets and liabilities, and it gives the financial picture of the business as of a certain date, for example, at the end of the year.

In order to understand a balance sheet, one needs to understand what assets, liabilities and equity is.

An asset is a resource controlled or owned by the enterprise (or individual) as a result of past events and from which future economic benefits are expected to flow to the enterprise or the individual.

In financial accounting, a liability is defined as an obligation of an entity arising from past transactions or events, the settlement of which may result in the transfer or use of assets, provision of services or other yielding of economic benefits in the future. A liability is a present obligation of the enterprise or individual arising from past events, the settlement of which is expected to result in an outflow from the enterprise or individual of resources embodying economic benefits.

Equity is the residual interest in the assets of the enterprise (or individual) after deducting liabilities and it represents the interest of the owners of the business.

example

Balance sheet

ASSETS	
Current Assets	
Cash	R 23,354
Raw Material Inventory	R 26,070
Work-in-Process Inventory	R 750
Accounts Receivable	R 16,800
Total Current Assets	**R 66,974**
Fixed Assets	
Land	R 4,000
Building	R 20,000
Machinery and Equipment	R 9,000
Office Equipment	R 1,000
Less: Accumulated Depreciation	R 3,400
Total Fixed Asset	**R 30,600**
Other Assets	
Pre-Operating Expenses	
TOTAL ASSETS	**R 97,574**
LIABILITIES	

Current Liabilities	
Accounts Payable	
Loans Payable	R 14,004
Total Current Liabilities	**R 14,004**
Long-term Liabilities	
Loans Payable	R 42,012
Total Long-Term Liabilities	**R 42,012**
OWNER'S EQUITY	
Accumulated Capital	R 27,000
Add: Net Profit after Tax	R 29,558
Less: Withdrawal / Dividends	-
Total Owner's Equity	**R 56,558**
TOTAL LIABILITIES AND EQUITY	**R 112,574**

practical

Complete the following formative assessment:
F114584.3 – Paired Work Sample Presentation

Chapter 4
Obtaining Financing

Collateral Requirements for Accessing Funding

When you are in search of funding, there will be a point where you may need to show proof of some asset that you own that can be used to pay off the loan if you renege on your repayments. Collateral serves as security to the bank in the case of you defaulting on your loan.

You can understand that a financial institution cannot be expected to give loans to just anyone at whim. They need to make sure that in case you cannot repay (perhaps even through no fault of your own), then they will still be able to get their money back.

When purchasing a fixed or movable asset such as property (buildings or land), vehicles and / or equipment, the asset itself can serve as collateral to the bank. If you do not repay the loan, the financial institution will merely repossess the asset (take possession of it), and either sell it through auction or other means, to repay your debt to them. This can hold many risks for you! You will be blacklisted (and it takes a long time for your name to be cleared so that you could become eligible again for financial assistance), or the bank may not be able to sell the asset for the amount that you still owe, still leaving you with the debt!)

Very rarely, if at all, do banks accept personal assets such as jewellery or furniture as collateral. However, institutions that offer such items for sale on credit could use repossession as a means to repay a debt to them.

As a small business entrepreneur building up fixed or moveable assets is the best means of securing collateral for future loans.

Compiling a New Venture Proposal

When writing a proposal to source funding for a new venture it is important to ensure that the entire proposal presents the viability of the proposed business. A proposal is one mechanism for businesses to express their innovative ideas and obtain funding to develop their ideas into quality products and services (see Appendix E for guidelines on writing a winning proposal).

If your proposal aims to obtain a loan from a bank then the proposal should also indicate the equity that the entrepreneur or business is bringing to the venture. If this equity is in the form of fixed or moveable assets, then these can be listed and costed to demonstrate their cash value. This will aid the financial institution in determining whether they feel secure enough in your ability to repay the loan, or if you default, that they will be able to repossess an asset that they can use to repay your debt.

The information and backup documentation needed to process an application for funding is collected and used to complete the application.

Waiting for a loan approval can feel like an eternity. The good news is that there are things you can do to expedite the process. Preparing all the documents you will need is one way to move the process along. See also Appendices A, B, C and D for more information regarding loans.

Here are some documents to collect for your application:

- **Business profile.** This document describes your business, including annual sales, number of employees and length of time in business, and ownership. Also include documents such as company registration documents, tax clearance certificates, shareholder certificates, ID documents of shareholders, BEE scorecard, any registrations and accreditations, and any other documents that can show the bank that you are a serious, committed business who has taken effort to ensure legislative and professional compliance.
- **Business plan.** A business plan is particularly important for new businesses (because new businesses lack a track record for lenders to go by). Your plan should convey all the important facts about your business in a concise manner. Your business plan may range anywhere from 5 to 20 pages, plus financial projections. Learn to write a winning business plan! Taking a slower approach to starting your business will give you the time to think through all the hurdles and challenges that can and do arise. A business plan is a useful tool to help you through this thinking process. Start working on a business plan as soon as your ideas begin to come together, then develop and modify your plan as your ideas develop and change. Remember: a business plan is never cast in stone. It is there to ensure that you know what you are aiming at and that you've thought about how you'll get there. The plan, it is said, never survives the first battle! So you need to keep updating it.
- **Loan request.** This should detail the amount of money requested, how the loan funds will be used, the type of loan, and the amount of working capital you have on hand.
- **Collateral.** Describes what will be used to secure the loan, including equity in the business, borrowed funds, and available cash. Review the information in "Should You Personally Guarantee a Loan to Your Small Business?" (Appendix A).
- **Personal and business financial statements.** You will likely need to provide financial information for anyone who owns 20 percent or more of the business, including owners, partners, officers, and stockholders. Lenders will want to see a complete schedule of current debts with balances, payment schedules, maturity, and collateral used to secure other loans.

You may also be asked to provide:

- Balance sheets from the last three years
- Profit and loss statements from the last three years
- Cash flow projections indicating how much cash you expect to generate
- Accounts receivable and payables ageing; breaking your receivables and payables into 30-, 60-, 90- and past 90-day-old categories
- Personal financial statements listing all personal assets, liabilities, and monthly payments, as well as your personal tax returns for the past three years

Lenders may also require additional documents during the loan process, such as:

- Articles of incorporation
- Proof of taxpayer ID number
- Legal descriptions of real property
- Leases
- Equipment inventories with serial numbers
- Proof of insurance for collateralised items

There are other documents that may improve your chances of getting approved. Some of those are:

- Letters of intent from commercial accounts stating their intention to do business with you
- Market data showing demand for your type of business
- Research on competitors, including information on their customer base and price points

Collecting this additional information is a good idea, but do not submit it with your application unless your loan officer requests it. Too much information can be overwhelming and actually hurt your chances of getting a loan.

It is necessary to ensure that you understand what information financial institutions are looking for in order for you or your business to access the type of finance required. If you cannot provide the correct information quickly this will delay your application and probably nullify it. Here are some of the things to remember when sourcing finance from financial institutions:

- Show a clear ability to repay the loan (best demonstrated through the cash flow statement and / or owner's equity or collateral).
- Ensure your own adequate contribution to the deal (owner's equity).
- Have on hand up-to-date financial records, especially including profit and loss statement and balance sheet (assets and liabilities statement).
- Ensure you have a sound credit record (check with every credit bureau every year to ensure that your name is clear of debt).
- Demonstrate knowledge of your chosen field.
- Ensure you have sufficient collateral for the finance required.
- Demonstrate business management skills for example financial management / selling.
- Prepare a well thought out business plan that you understand and are confident about.
- Be professional in everything you do such as presentations.
- Seek professional advice if there are certain things you do not understand, or where your expertise is lacking in that particular area.
- Do NOT submit fraudulent documents such as ID copies and bank statements.

Choosing a Financing Option

Before deciding on a particular financial product such as a loan or an overdraft you should assess whether it is going to help you reach your financial goals or whether it is actually going to impede growth. It is possible to do this assessment even before you take the loan. This is especially the case if you have made a good effort with your cash flow statement or your profit and loss statements, wherein you would include the cost of repaying your debt. Including these figures will allow you to determine whether you still have good cash flow every month or whether you will still be able to make a profit even though you are still repaying the debt. Just because you have debt does not mean that you cannot make a profit. Debt repayments are merely a monthly cost to the business and will also be captured in your asset and liabilities statement. However, it need not be brought into the equation every time you determine whether you are making a profit.

If profit is made, a decision can be made to repay a large portion or all of the loan. This will generally leave you with an asset thus improving your balance sheet and reducing your monthly expenses.

So you see, using a loan should allow you to grow your business, attain assets, and accumulate leverage with which to obtain a further loan for further growth and asset accumulation.

Use the return-on-investment calculation to determine whether a loan will allow you to achieve your business goals of growing your business and accumulating assets.

Return on Investment

A useful tool to use to determine whether your business resources are contributing to your overall business objective is the concept of return on investment (ROI).

definition

What does return on investment (ROI) mean?

ROI is a performance measure used to evaluate the efficiency of an investment or to compare the efficiency of a number of different investments.

To calculate ROI, the benefit (return) of an investment is divided by the cost of the investment. The result is expressed as a percentage or a ratio.

The return on investment formula:

$$\text{ROI} = \frac{\text{Gain from Investment} - \text{Cost of Investment}}{\text{Cost of Investment}} \times 100$$

Return on investment is a very popular metric (measure) because of its versatility and simplicity. That is, if an investment does not have a positive ROI, or if there are other opportunities with a higher ROI, then the investment should not be undertaken.

example

Let us say a hair salon manages to get start-up capital in the form of a loan of R 50,000. The monthly loan repayment instalment is R 1,500 for 50 months.

According to its business plan, the start-up expenses to operationalise the salon is R 45,000 (buying products, machinery, and mirrors). In the first month of operation, a profit of R 10,000 is generated. Thus, it can be argued that the loan of R 1,500 per month contributes to the realisation of R 10,000 profit for that month.

That is a return on investment of 566% (using the ROI calculation above). This ROI can also be described as the performance of the loan in contributing to the objectives of the business. If the ROI calculation had provided a negative result, it is a clear indication to the entrepreneur that this business (and the loan required to start it up) would be a poor investment.

Financial Services Laws and Rules

Every financial institution and its operations are governed by laws, regulations, rules, and procedures that these financial institutions must or must not practice.

Most of these laws and regulations are there to protect the rights of consumers. In order to acquire funding for a new venture, there are requirements that need to be met in order to obtain that funding. If one or two of those requirements are not met, the chances of obtaining that funding are minimal to zero. This means you will need to meet those requirements first in order to be considered for that funding (see documentation requirements mentioned above).

Financial institutions, especially banks, are regulated by the National Credit Act (NCA) in order to ensure that they do not finance individuals who will be, or are, over-indebted. Do not believe that they do not want to grant you a financial product because of who you are. The law requires that they must obtain certain assurances from you regarding your financial capabilities. If you land up being overly in debt because of negligence on their part for providing you with a loan, then the law will prosecute them. You will however also be prosecuted for your indebtedness.

So, see these financial information requirements of the bank as the bank's means to assist you to stay out of financial trouble.

Difference between Debt and Equity

Debt (for example a loan) is created when a creditor agrees to lend a sum of assets to a debtor. In modern society, debt (loan) is usually granted with expected repayment including interest. As the owner of a business idea, you hold ownership to a subjective value called equity. The equity of any type of property whether intellectual or physical is the value of an entity today measured in time and money invested versus the value in the future measured by comparable growth.

Raising capital through debt financing does not entail selling equity but instead, works by borrowing against it. Debt financing is only available to business owners who have something of value that the lender can instantly liquidate. Lenders are not interested in a partnership with you or your business. However, they are in business to make money from their money, by letting the borrower use it for a period of time.

Alternative Sources of Equity

There are various sources of capital such as:

Relatives

Surprisingly, in a recent survey, almost 30% of entrepreneurs said that they raised all or part of the capital they needed through family members.

Own Savings or Credit

This is the common way for entrepreneurs to raise needed business capital. Before choosing this method, it is important to talk to financial advisors. You want to look at the long-term consequences of using your savings, life insurance, credit cards, especially in the event that your business venture fails, or does not bring in the projected return on investment (ROI).

Venture Capital

Most venture capitalists do not invest in start-up businesses. They want to assist a tried-and-tested business recipe or product and will often assist to grow a business.

Potential or Current Employees

One of the best ways to raise capital for your business is by giving your potential or current employees the opportunity to become investors or shareholders. When doing this you get a genuinely committed workforce, create renewed energy in the business, and, if not already, it may help your company to become BBBEE compliant. Selling shares to your employees needs to be properly structured by an attorney, business or financial consultant and requires some legal paperwork.

Government Funding Schemes

Several National, provincial and parastatal departments have programmes specifically targeted to assist entrepreneurial development. Some of these will be discussed in the next section.

The South African government through its national and provincial departments and several parastatals offer a wide range of financing programmes to help small businesses start up and grow. These programs include low-interest loans, venture capital, and scientific and economic grants.

Can you name some of them?

information

1. National Empowerment Fund

Mission Statement

The National Empowerment Fund (NEF) is the catalyst of broad-based black economic empowerment (B-BBEE) in South Africa. The NEF enables, promotes and implements innovative investment and transformation solutions, to advance sustainable black economic participation.

Strategic Role and Positioning

The NEF's role is to support B-BBEE. As the debate around what constitutes meaningful and sustainable B-BBEE evolves, the NEF anticipates future funding and investment requirements to assist black entrepreneurs and communities achieve each element of the codes of good practice.

These include a focus on preferential procurement, broadening the reach of equity ownership, transformation in management and staff while preventing the dilution of black shareholding.

The NEF differentiates itself not only with a focused mandate for B-BBEE but by also assuming a predominantly equity-based risk to maximise the empowerment dividend. The reward should balance the risk, with the application of sound commercial decisions to support national priorities and government policy, such as the Accelerated and Shared Growth Initiative for South Africa (AsgiSA) or targeted investments through the DTI's National Industrial Policy Framework (NIPF).

The work of the NEF, therefore, straddles and complements other development finance institutions (DFIs) by allowing the organisations to work in close collaboration with each other. Close cooperation with these institutions, and the sharing of its special sector expertise and knowledge, enables the NEF to add value to the work of other DFIs and further contribute to the realisation of their mandate.

Products and Services

Entrepreneurship Fund – This product aims to address the financing needs of black small and medium-sized enterprises (SMEs). The product supports both the creation of new black SMEs, as well as the provision of expansion capital to black businesses that are already empowered.

Procurement Finance – The product seeks to provide access to finance to black SMEs that have been able to exploit opportunities available as a result of preferential procurement initiation.

Franchise Finance – The franchise fund is geared towards enabling black people to leverage the infrastructure available in the franchise industry, in order to gain access to economic opportunities.

Project Equity Finance – The product addresses the financing requirements of BEE parties seeking to participate in medium-sized projects.

Rural and Community Development Programme (RCDP) – In accordance with the B-BBEE Act, the RCDP facilitates increasing the extent to which workers, cooperatives, and other collective enterprises own and manage business enterprises. Also, it supports the B-BBEE Act's objectives of empowering local and rural communities.

Acquisition Finance – The acquisition finance product supports black entrepreneurs seeking to acquire equity stakes in existing businesses. The product represents the NEF's intervention in addressing the black equity ownership requirements of the BEE codes of good practice.

Capital Market – The product is targeted at companies seeking to enlist on the Johannesburg stock exchange (JSE) or the AltX markets. The product facilitates the participation of BEE groups, and in particular black women, in the equity ownership of targeted companies. The product also caters for expansion capital to listed BEE companies.

2. Khula Enterprise Finance

Mission Statement

To provide finance, mentorship services, and small business premises to small and medium Enterprises (SMEs) through a network of partnerships, and to encourage the sustainable development of SMEs, whilst ensuring that Khula remains financially viable.

Overview

Khula is a state-owned development finance institution that was established in 1996 to facilitate access to finance for small, micro, and medium enterprises (SMMEs), by providing finance, mentorship services, and small business premises. It is the government's flagship development finance institution (DFI) for small business, which fulfils a public policy mandate to address market deficiencies in the SME financing sector, through a network of partnerships with banks, retail financial institutions (RFIs), joint ventures (JVs) and specialist funds. The organisation acts as a complementary financial institution that bridges the financing gaps not addressed by the commercial financial institutions.

Khula reports to the Minister of Trade and Industry, Dr Rob Davies, and is registered as a limited liability public company. Khula is dedicated to the development and sustainability of small business enterprises in South Africa.

The company is a wholesale finance institution, which operates across the public and private sectors, through a network of channels to supply much-needed funding to small businesses. These channels include South Africa's leading commercial banks, retail financial institutions, specialist funds and joint ventures, in which Khula itself is a participant. Its primary aim is to bridge the funding gap in the SME market not addressed by commercial financial institutions.

The institution was created as part of the institutional framework envisaged in the 1995 Department of Trade and Industry (DTI) White Paper on the National Strategy for the Development and Promotion of Small Business. Khula is the cornerstone of the DTI's institutional support framework for financing SMEs.

Legislative Framework

Khula falls under the auspices of the Directorate of Enterprise Development (formerly the Centre for Small Business Promotion) within the DTI. Khula is an independent, limited liability company with its own board of directors.

Khula's creation originated from the National Strategy for the Development and Promotion of Small Business to meet the challenges of creating sustainable jobs, supporting SMEs and thereby enabling previously disadvantaged communities to integrate into the mainstream economy.

Mandate

<u>Maximisation of Access to Finance for SMEs</u>

Khula's primary mandate is to intervene in underserved segments of the SME finance market, in order to increase access to finance for small enterprises. A measure of Khula's success in this area is the extent to which it attracts private sector partners to enter the market. In addition, Khula needs to ensure that the impact of its programmes is felt by as many SMEs as possible within its target group. In other words, it should narrow the SME financing gap.

<u>Maximisation of Development Impact</u>

In addition to maximising access to finance, Khula is mandated to ensure that its resources are applied in a manner that maximises development impact. The key measures of development impact are sustainable job creation, black economic empowerment (BEE), women empowerment, the geographic spread of its funding activities and the development of the entrepreneurial potential of rural and urban poor communities.

<u>Financial Sustainability</u>

Khula has to maximise access to finance for SMEs and maximise development impact while remaining financially sustainable itself.

A long-term objective for Khula as an institution is to attain the capacity to be self-funding. This will be achieved through:

- Gradually changing the pricing from a subsidised basis to one reflecting market conditions, as more players enter the market.
- Optimal asset utilisation (capital, people, infrastructure) and leveraging the resources of its partners.
- Diligent cost management and control.
- Effective risk management, through appropriate levels of due diligence, post-investment support and portfolio management.

Khula offers non-financial services (mentorship programme) and financial services. As a wholesale financier, Khula leverages its own resources as well as those of its partners.

Acquisition Finance – supports black entrepreneurs seeking to acquire equity stakes in existing businesses. The product represents the NEF's intervention in addressing the black equity ownership requirements of the BEE codes of good practice.

Mentorship Programme – offers pre-loan and post-loan assistance to existing and potential Khula clients. During the pre-loan stage, entrepreneurs are assisted by experienced mentors with advice, counselling and the development of viable business plans in order to access funding.

Khula Land Reform Empowerment Facility (LREF) – offers financial assistance to emerging black farmers and entrepreneurs, who wish to invest in agriculture or agro-processing projects. The LREF enables black South Africans to control, manage and own land-based income-generating assets in the agricultural sector.

Non-Bank Retail Financial Intermediaries (RFIs) – are independent organisations or companies that receive loan funds from Khula to lend to SMEs, according to their own lending policies. RFIs are required to ensure that loans disbursed are paid back by the SMEs, in order to pay back the loans originally received from Khula.

Khula Credit Indemnity Scheme – the purpose of the scheme is to share the financing risk with the commercial banks, thus enabling SMEs to access funding from the participating banks. The scheme enables entrepreneurs to access funding for the purpose of establishing, expanding or buying out an existing business, business assets, and working capital. Finance has to be approved by the participating bank and the bank will only apply to Khula for an indemnity where there is inadequate collateral.

Khula Joint Ventures

Khula has a number of joint venture funds with different companies to assist the financing of entrepreneurs. These funds are managed by the companies with which Khula has partnered.

The joint ventures funds are:

- **Business Partners / Khula Start-up Fund** – is a joint venture initiative between Khula and business partners. It was created to help entrepreneurs financially to establish new enterprises, as well as early phase business expansion.
- **Anglo-Khula Mining Fund** – is a joint venture initiative between Khula and Anglo American, which provides seed capital to junior mining projects at pre-feasibility and pre-commissioning phases.
- **Regent Factors Reverse Factoring** – is a joint initiative between Khula and Regent Factors, aimed at addressing the cash flow gap experienced by SMEs that have been awarded contracts by public and private sector entities. The fund allows entrepreneurs to access working capital, thus reducing the time gap between the delivery of goods or services and recipient payments.

- **Enablis-Khula Loan Fund** – is a joint venture initiative between Khula, Enablis Entrepreneurial Network, and FNB Enterprise Solutions. The fund provides loan guarantees for loans extended to information and communication technology (ICT)-focused businesses.
- **Khula-Enablis SME Acceleration Fund** – This fund is not sector specific, as it assists businesses including transportation, tourism, agriculture, and services. It aims to provide risk capital funding to entrepreneurs with start-up and early-stage businesses.
- **Property Portfolio** – Khula provides industrial and retail premises to small businesses at subsidised rentals. Premises vary from shops to mini-industrial units used for manufacturing. The properties are located in seven regions: Gauteng, Western Cape, Eastern Cape, Northern Cape, Free State, KwaZulu-Natal, and Mpumalanga.

3. South African Micro-Finance Apex Fund (SAMAF)

Mission Statement

To provide developmental financial and non-financial intermediaries through:

- Effective mobilisation and wholesaling of capital micro-finance institutions with proven potential.
- Development of human capital in the economic environment through capacity building and institutional development.
- Contribution to policy development, in respect of micro-finance, by informing and supporting South African Micro-Finance Apex Fund (SAMAF) staff, its partners, and stakeholders.
- Development of valuable partnerships between business, government, and the community.

Overview

SAMAF was approved to operate in terms of Section 38(1), read together with Section 76(4)(b) of the Public Finance Management Act, 1999, as a trading entity, in April 2006.

Strategic Goals

- Contribute to poverty alleviation goals
- Exceed our stakeholder expectations
- Improve processes to achieve service delivery excellence
- Leverage performance through capability and people
- Build a sustainable apex fund

Products and Services

SAMAF's products and services include loans and institutional capacity building funds.

4. Export Credit Insurance Corporation (ECIC)

Mission Statement

To facilitate and encourage South African export trade, by underwriting export credit loans and investments outside the country, in order to enable South African contractors to win capital goods and services contracts in other countries.

To support this mission, the Export Credit Insurance Corporation (ECIC) of South Africa:

- Evaluates export credit and foreign investment risks and provides export credit and foreign investment insurance cover on behalf of the government.
- Focuses on underwriting of medium- and long-term loans and equity investments for the export of capital goods and services from South Africa.
- Extends its services as far as it can, consistent with preserving the financial viability essential to its long-term support of exporters of capital goods and services.
- Provides sound and efficient financial services that contribute to public confidence and comply with international standards.

Through its mission, the corporation is committed to attaining the strategic goals of the government, namely:

- Acceleration of economic growth
- Creation and preservation of employment opportunities
- Reduction of economic inequalities

Overview

The ECIC:

- Is a self-sustained state-owned national export credit agency
- Is a registered insurer and is subject to the supervision and regulation of the Financial Services Board
- Underwrites bank loans, supplier credits, and investments outside South Africa in order to enable South African contractors to win capital goods and services contracts in other countries
- Is subject to normal income tax at corporate rates
- Follows normal company policies and procedures in its operations
- Conducts its business in a transparent manner, with its annual report made freely available to the public

Strategic Goals

- Focusing on customers: providing high-quality service to all clients including exporters, financial institutions, investors, host country authorities, and buyers.
- Enhancing performance: building a high-performance organisation, operating on an effective and self-sustaining basis through prudent underwriting and sound risk management practices.
- Engaging in strategic alliances: forging partnerships and alliances with other insurers, government agencies and international organisations to complement services and leverage resources.
- Fostering risk orientation: create enterprise-wide risk awareness and the application of effective risk management techniques.
- Providing effective stewardship: consistently utilise sound business, environmental and social principles, applying international best practice.

ECIC Products

<u>Investment Insurance:</u>

<u>Equity Investments</u>

A South African entity carrying out business in South Africa, and investing in another country, can be provided with protection against political and related risks. To qualify for this cover, an investment must adhere to the following criteria:

It must be a new investment and could be associated with a new project, as well as the expansion or financial restructuring of existing projects and acquisitions, involving the privatisation of state-owned enterprises.

Approval must be obtained from the host country government and the South African Reserve Bank.

The South African entity must hold at least 26% of the paid-up share capital with voting rights in the foreign entity (however, with adequate protection of minority rights, a shareholding of less than 26% may be considered).

<u>Shareholder Loans</u>

Shareholder loans advanced to the foreign entity can also be covered against political and related risks, such as:

- Expropriation, that is the nationalisation or confiscation of the insured investment, which will include the gradual erosion of the profitability of the foreign business by actions of the foreign government which are discriminatory against the foreign business with the result that the foreign business cannot operate for at least 1 (one) year, as envisaged, or produce profits for 3 (three) consecutive years.
- War, in other words the loss or damage to the investment due to war, civil war, rebellion, revolution or insurrection in the foreign country as well as loss due to the inability of the foreign business to operate for at least 1 (one) year, as envisaged, or produce profits for 3 (three) consecutive years due to the above-mentioned occurrences.
- Transfer risk, that is loss directly due to any action by the designated government that prevents, restricts or controls the transfer of the investment and / or shareholder loan or commercial loan or dividends and / or interest from the foreign country to South Africa for a period of at least 365 (three hundred and sixty five) consecutive days.
- Indemnification by the ECIC will be limited to 90% of a loss suffered by an investor.

Premiums payable in terms of the investment insurance cover will take into account the following:

- Nature of the investment
- Country where the investment will be made
- Investment period to be covered and the ECIC's capacity
- Capital adequacy requirements of ECIC

<u>Commercial Loans</u>

Cover against political risks is offered to financial institutions that provide commercial loans to foreign enterprises or governments.

Such loans for the financing of investments could be associated with new projects, as well as the expansion or financial restructuring of existing projects and acquisitions, involving the privatisation of state-owned enterprises.

Eligibility for cover means:

- The facility must be provided by a financial institution conducting business in the Republic of South Africa or a subsidiary of such a financial institution, who will be the insured.

- The facility can be provided to any entity (public or private), or government or project outside of South Africa and such entity need not necessarily be a South African company or a South African owned company.
- Approval must be obtained from the host country government (if required) as well as the South African Reserve Bank for the provision of the loan.
- The ECIC cover will reduce the non-economic risk associated with a loan. The ECIC provides insurance cover against default on a loan repayment, where the direct cause of default is one of the political risk events mentioned under investment insurance coverage.

Levels of Cover

- 90% of the investment (actual shareholders cash equity invested), shareholder loan or commercial loan
- 90% of the value of dividends or interest (but not exceeding in aggregate over the insurance period, the amount of cash equity invested or capital amount of the loan)
- Minimum tenor of 5 (five) years and up to a maximum of 15 (fifteen) years

<u>Credit Insurance</u>

This insurance cover is linked to export transactions involving capital goods and / or project-related services, or undertaking of works of a capital nature in foreign countries. Through the provision of credit insurance to banks, the corporation facilitates term finance for such transactions / projects.

Insurance cover is provided for losses arising from:

- Political risk events
- Expropriation – loss incurred due to an expropriatory measure taken by the host government
- Transfer restriction – loss incurred due to any action taken by the host government that prevents the conversion of a local currency into SA Rand or US Dollars or the transfer of SA Rand or US Dollars outside that country
- War and civil disturbance – loss incurred due to acts of war, revolution, insurrection, civil war, civil commotion, terrorism, and sabotage
- Breach of contract – loss incurred due to a material breach by the host government of a contract entered into with the host government
- Protracted default – payment default by a government borrower / guarantor
- Commercial risk events
- Insolvency – sequestration, liquidation or judicial management of a borrower
- Protracted default – an undisputed payment default by a borrower

The corporation normally provides insurance for credit terms of a minimum of two (2) years, and up to a maximum of ten (10) years or more if required. Repayment periods of more than ten (10) years can be considered in exceptional circumstances, and in line with the Organisation for Economic Co-operation and Development (OECD) arrangement on export credits.

The premium cost relating to credit insurance cover depends on the perceived political and commercial risk in the host country where the goods / project will be delivered; the credit risk assessment of the borrower and / or the project; the length of delivery and repayment period; the ECIC's exposure and capacity in respect of the particular country and industry, and ECIC capital adequacy requirements.

Levels of Cover

Credit insurance cover against political risk includes cover for 100% of the loan amount, and normally 85% of the loan amount against commercial risk, provided the prescribed South African content is achieved.

South African Content

The minimum South African content required on projects supported by South Africa is 50%, however, no minimum percentage of South African content applies to projects in Africa, given the following:

- The exporter must be resident in South Africa as defined in terms of the Income Tax Act, No. 58 of 1962.
- The exporter must have entered into an export contract with a foreign buyer.
- The exporter must, in terms of the broad-based black economic empowerment (B-BBEE) scorecard, achieve a minimum score of 30%.

Should the above criteria not be met, the minimum South African content requirement for Africa will also be 50%.

South African content consists of:

- The cost of materials and manufactured goods purchased from South African suppliers minus the value of any materials, goods or major components of manufactured goods, which have been imported from sources outside South Africa.
- Wages, salaries and other remuneration paid by the exporter in South Africa to its employees and such portions of wages, salaries and other remuneration payable to the exporter's employees who are performing work outside South Africa, and which is paid by the exporter in South Africa.
- Freight charges paid in South Africa.
- Insurance premiums paid in respect of a policy issued in South Africa.
- Finance charges, excluding any interest for post-delivery finance, paid to any financial institution normally operating in South Africa.
- Fees and charges paid for any other services performed in South Africa on the exporter's behalf by a South African resident organisation.
- Fees and profits accruing to the exporter that have been confirmed by the ECIC / chartered accountants for qualification as South African content.

Performance Bond Insurance

The ECIC, in partnership with the Industrial Development Corporation (IDC), has developed the performance bond insurance product, enabling small, medium and micro enterprises (SMMEs) that face financing capacity hindrances, to participate in export projects of capital goods and services.

Product Criteria:

- The performance bond value is limited to a maximum of 10% of the South African contract price.
- The product is restricted to SMMEs only as defined in the National Small Enterprise Act, No. 102 of 1996.
- The value of the South African export contract may not exceed US$10 million.

- The credit term of the export transaction should be 2 (two) years or more.
- The performance bond is callable on demand.

5. Industrial Development Corporation of South Africa

Mission statement

The IDC is a self-financing national development finance institution, whose primary objectives are to contribute to the generation of balanced, sustainable economic growth in Africa and to the economic empowerment of the South African population, thereby promoting the economic prosperity of all citizens. The IDC achieves this by promoting entrepreneurship through the building of competitive industries and enterprises, based on sound business principles.

Overview

Established in 1940, the IDC is a self-financing, state-owned development finance institution. The vision of the IDC is to be the primary source of commercially sustainable industrial development and innovation to the benefit of South Africa and the rest of the African continent. It provides financing to entrepreneurs engaged in competitive industries and enterprises, based on sound business principles. The corporation also pays income tax at corporate rates and dividends to the shareholder. It aims to maximise developmental and financial returns within an acceptable risk profile.

Strategic Goals

The IDC's objective is to provide development finance, so as to support industrial capacity development and entrepreneurship.

South Africa has a diversified economy, with well-developed agricultural, mining, manufacturing and services sectors. However, certain areas of the economy still need further support and development in order for the country to realise its full potential. The IDC plays an important role in this development, by assisting with the development and implementation of government policies, and through identifying and addressing market gaps, bottlenecks and capacity constraints in the economy. In the rest of Africa, where economies are still largely focused on resource-based industries, the IDC's objective is also to unlock the potential of these resources and assist in the industrialisation and modernization of countries.

In order for the benefits of development to be felt throughout the economy, a strong entrepreneurial class is needed. The IDC develops entrepreneurs through its assistance to small and medium enterprises (SMEs), and through non-financial support to new entrepreneurs.

The outcomes achieved through the IDC's industrial capacity development and entrepreneurial support are determined by the corporation's mandate, with the orientation of the organisation being towards servicing the needs of the entrepreneurs and the business community. Through this, the corporation aims to achieve the following outcomes:

- Creating sustainable employment opportunities
- Growing sectoral diversity
- Supporting new entrepreneurs entering the economy
- Supporting broad-based black economic empowerment (B-BBEE)
- Support for SMEs
- Promoting regional equity, including:

- Development of rural areas
- Supporting development in poorer provinces
- Stimulating economic activity in previous townships
- Industrialisation in the rest of Africa
- Supporting export-focused enterprises
- Ensuring environmentally sustainable growth

Products and Services

The IDC offers a wide array of financial instruments for businesses, including:

- Equity
- Quasi-equity
- Commercial debt
- Wholesale finance
- Bridging finance
- Share warehousing
- Export / import finance
- Short-term trade finance
- Venture capital

These instruments may be provided independently or in combination.

Option of Leasing

If you want your business to be successful you may need to be flexible or change your original plan. For example, your initial plan was to buy a piece land and build your own infrastructure. However, when you do your calculations and cash flow you realise that you do not have enough capital to buy that land or to build that building. Most businesses do not own the premises that they operate from. Businesses owning property are by far the exception rather than the rule.

Instead, you should consider leasing an existing infrastructure for a certain period and use it until your business is able to buy itself that piece of land. The rental amount is then the amount that will be included in the cash flow. Remember to always sign a lease agreement which specifically details your roles and responsibilities versus the roles and responsibilities of the owner or the rental agency. For example: If a water pipe breaks and floods your business are you responsible for fixing the pipe? What about the damage to your property? Will the owner pay for your damage? You will probably need to have insurance to cover this type of damage. However, whatever the case, make sure that all types of situations are clearly explained in the lease agreement.

Most rental agreements require that a deposit to the value of one month's rental be paid. You will also need to connect the water and electricity with the municipality and ensure that the bill from them is sent to you in your name.

Because the initial capital requirements of renting is less than buying or building a business premises a decision to rent may result in quicker growth and sustainability of your business.

Remember, however, before going into any agreement to do your calculations! Specifically, do an ROI calculation to see whether the rental will "earn" income for your business. The option may be to run your business initially from your home. But, perhaps you need the "foot traffic" or more parking and this may be a serious consideration to renting a business premises in town.

Always consider and compare the repayment requirements and interest rates of the alternative options.

The Government programmes that support entrepreneurial development listed above each have their own interest rates and repayment requirements. It is necessary to compare the repayment requirements and interest rates of these programmes to the different commercial financial institutions and their products before you decide to enter into an agreement with them.

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Complete the following formative assessment:

F114584.4 – Team Mind-map with Key Notes

Section 1: Self-Assessment and Progress Check

Determine the capital requirements of the new venture.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Funding requirements and capital structure are identified and analysed for the new venture.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Realistic fixed asset requirements are determined for the new venture.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Pre-operating costs are identified and calculated to an exact value.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Monthly operating costs - including a cash flow statement - are compiled for the new venture.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
The financial viability of the proposed new venture is assessed and an estimation made of the break-even point.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
Identify and compare funding options and services offered by the finance industry for new ventures.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
An extensive list of financial institutions offering funding for new ventures is compiled with a view to selecting the one best suited to the particular venture.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
The various funding packages (products) appropriate for a new venture are investigated and compared in terms of own venture needs.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment
The cost of the various funding options is compared to determine suitability for own venture's business structure.	❐ I have the answer and am ready to start with assessment	❐ I am still not sure of this and am not ready to start assessment

Short-term and long-term advantages and disadvantages of the various funding options are considered and discussed in the context of own business and a decision made as to the most suitable.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Compile personal income and expenditure, and assets and liabilities statements.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Personal income and expenditure statements are prepared for oneself based on own financial situation over the past year.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The situations when an assets and liabilities statement is required are listed and an indication is given of the advantages of keeping such records.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Identify the requirements and processes to obtain the selected financing option for the new venture.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Collateral requirements for accessing funding are identified to determine if they can be met.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The new venture proposals are assessed in terms of available collateral.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The information and backup documentation needed to process application for funding is collected and used to complete the application.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
A financing option is chosen that is consistent with the business plan in terms of profit objectives and return on capital.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Laws, regulations, rules and procedures covering the provision and use of financial services are observed to ensure compliance.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Identify alternative sources to secure finance for a new venture.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The difference between debt (loans) and equity (owner's capital) is explained with reference to the new venture.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment

Problems faced in obtaining finance for the new venture are identified with a view to overcoming them.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Alternative sources of equity are investigated for the new venture.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Government and non-governmental schemes for new venture creation are investigated and analysed and an explanation given of their advantages and disadvantages for the new venture.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The option of leasing as a method of reducing start-up capital is considered for own venture.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The repayments and interest rates of the alternative options are considered and compared to those of the financial institutions to make informed decisions.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment

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Section 1: Additional Resources

Appendix A

Should You Personally Guarantee a Loan to Your Small Business?

You may not think twice about signing a personal guarantee for your business. After all, you believe wholeheartedly that your business will succeed. However, many financial experts would urge you to personally guarantee a business loan only as a last resort. If your business goes belly up, you stand to lose major personal assets — most likely your house.

Before you decide to personally guarantee a small business loan, think about what a personal guarantee means. The guarantee applies only to you, not to your business partners nor to your managers. It means that you are declaring an individual pledge to make good on the loan, usually without exception. Depending on how your contract is written, you may be responsible for the loan even if your business is protected by limited liability laws. Many lenders require borrowers to personally guarantee a loan or secure it with personal assets if your business is organised as a limited liability entity.

You may even be responsible for the loan after your business has been dissolved. When you issue a personal guarantee, you are acting as a co-signer on the loan. As such, creditors will go after you in the event that the borrower — your business — fails to make the loan payments.

But every loan carries some degree of risk, even if you do not personally guarantee it. In some cases, a lender may have the right to sue you personally if your business is a sole proprietorship or general partnership. If the lender successfully sues you, they can confiscate your personal assets to satisfy the loan. Another thing to consider is that if you are married, your spouse may have to co-sign the promissory note. In that event, your jointly owned possessions are on the line for the debt, as well as your spouse's assets and income.

If you have exhausted all your other financing options, a personal guarantee may be your last resort. Guaranteeing a loan for your business demonstrates a high level of personal commitment to your business, which lenders like to see. Keep in mind that if you personally guarantee a loan to a business, you can expect a phone call from the lender if things go south.

Appendix B
Top 10 Mistakes Made When Applying for a Business Loan

Whether you are applying for a business loan or a personal loan, there are common mistakes that can hinder the process. Below are 10 of the most common mistakes made when applying for a loan.

- **Not knowing your credit rating.** Before you apply for a loan, you need to know where you stand. Get copies of your credit scores from the major credit bureaus so you will know if you are likely to get the loan approved.
- **Not reading the terms carefully before signing.** In your haste to get a loan, you may commit the common mistake of jumping the gun and signing without reading the details and terms of the loan. Not only should you take the time to read everything very carefully, but you should also ask questions about anything you do not fully understand.
- **Not locking in a rate.** Interest rates change. If you think you've found a good rate, lock it in before it goes up. Too often, people make the mistake of getting greedy and waiting for interest rates to drop further.
- **Not explaining what the loan is for.** When applying for a business loan, you need to indicate how the money will be used. Lenders want to see that you know exactly what your needs are and how this loan will meet those needs.
- **Making major changes.** Just as you do not want to open and close various credit cards before applying for a personal loan, you do not want to make significant personnel or other changes to your ongoing business structure before applying for a business loan. Lenders want to be able to see stability in how you do business and with whom.
- **Applying only to the most convenient lender.** Although there are various lenders available, many people still head to their local bank first without shopping around. Khulisa, Ithala, and other sources are worth investigating.
- **Not having your finances up-to-date.** Whether you are seeking a personal or business loan, you should not apply without having the proper financial documentation. This is an area where many people put the cart before the horse and try to get a loan without making sure their financials are up-to-date.
- **Failing to have some equity in the project.** Not unlike a down payment when buying a home, having some equity in a business project significantly enhances your chances of securing a business loan. If you are not invested in the project, or in the business itself, the lender will be less enthusiastic about taking on such a risk.
- **Having no collateral.** You need to provide some collateral, should there be a default in payment.
- **Not having a business plan.** If you are starting a business, you need to demonstrate how the business will operate and make money. A business plan is essential for a lender to see your goals and specifically, how you intend to reach them. You must include all applicable supporting data, including financials.

Appendix C
Key Business Loan Issues

When you start a business, you generally have two ways to raise capital: loans and equity contributions. There are some obvious disadvantages to loans. They require you, for example, to pay back the lender whether or not the business is successful, which is not the case with equity contributions. But the advantage of a typical loan is that if your business prospers, the lender is only entitled to an interest return on its loan — not a percentage of the profits or a share in the company that an investor would expect.

Whether you obtain loans from a bank, individuals or other lenders, a number of variables can affect how good or how bad they are for your business. Virtually all of these variables are negotiable: There is no such thing as a "standard loan".

Be sure to negotiate these key issues if you plan to get a loan for your business:

- **Due date.** You need to set a date when the loan is to be repaid. This can be formulated as a lump-sum payment at the end of the term of the loan or as a periodic payment of principal with a final payment. For example, you can agree to borrow R 50,000, with the entire principal due in two years, or you could agree to repay the principal in 20 equal monthly instalments of R 2,500. In any event, make sure that the payment schedule is reasonable given your anticipated cash flow. Realise that interest will be charged to you either way.
- **Interest payments.** When a lender establishes an interest rate, it must comply with any applicable state usury laws. (These laws govern how much interest can be charged on a loan.) Often, however, usury laws will not apply to banks. The law may also allow a lender to charge a higher interest rate for business loans than for personal loans (such as consumer credit). The interest payment dates should be clearly defined — the most common method requires monthly interest payments due on the first day of each month. You might also try to adjust the timing of your interest payments to match the cash flow patterns of your business.
- **Loan fees.** The lender may charge up-front loan or processing fees. Check these fees carefully, and try to get an estimate as soon as possible to help you evaluate the loan package.
- **Prepayment.** Ideally, you want to be free to pay off the loan at any time before its due date. Make sure that your loan agreement or promissory note gives you this flexibility and try to avoid a prepayment penalty for paying off the loan early.
- **Defaults.** The lender may define a variety of events that will constitute a default on the loan, including failure to make any payment on time, bankruptcy, insolvency and breaches of any obligations in the loan documents. Try to negotiate advance written notice of any alleged default, with a reasonable amount of time to cure the default.
- **Grace period.** Try to get a grace period for any payments. For example, the monthly payments may come due on the first day of each month, but they will not be deemed late until the fifth day of the month.
- **Late charge.** If the loan includes a fee for late payment, try to make sure that it is a reasonable charge.
- **Collateral.** The lender may insist on a pledge or mortgage of some asset to secure the loan. Under a mortgage (for real estate property) or a security agreement (for personal property), if you default on the loan, the lender is able to foreclose upon the asset and sell it to repay the money owed to the lender. If you are required to provide security, try to

limit the amount you have to give to secure the loan. And make sure that when the loan is repaid, the lender is obligated to release its mortgage or security interest and is required to make any government filings acknowledging this release.

- **Co-signers and guarantors.** A lender may ask for a co-signer or guarantor as a way to further ensure that the loan will be repaid. A co-signer or guarantor runs the risk that their personal assets will be liable to repay the loan. If you ask someone to co-sign the loan with you, you may want to draw up a co-signer agreement to let the person know how you will repay them if you default on the loan.
- **Attorneys' fees.** The lender will likely insist on a clause that says in the event of any failure to pay on the loan, the borrower will reimburse the lender's fees and costs in enforcing or collecting on the loan. Try to insert a qualifier that the reimbursement will cover only "reasonable" attorneys' fees.

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Appendix D
10 Ways to Help Increase Your Cash Flow

As any small business owner knows, maintaining smooth cash flow requires juggling nearly every facet of a business, from staying on top of accounts receivable to extending lines of credit, to managing inventory. The essence of successful cash flow management is regulating the money flowing in and out of your business. Increasing your cash flow reduces the amount of fixed capital that you need to support the given level of your business. An increased, consistent cash flow also creates a predictable business pattern, making it easier to plan and budget for future growth.

Here are 10 things you can do to increase your cash flow:

- **Organise your billing schedule.** The faster your receivables turn over, the more capital you'll be able to spend on growing your business. To help you bill early and often, put yourself on a billing schedule with an accounting software programme like Intuit's QuickBooks or Pastel Accounting. These two programs can automatically classify the age of accounts receivable — fewer than 30 days old, between 30 and 59 days, between 60 and 90 days. This kind of automated flagging system allows you to act immediately on overdue accounts.
- **Stretch out your payables.** Take the maximum amount of time allotted (often 60 or 90 days) to pay your suppliers. Think of these terms as an interest-free line of credit from your supplier. It gives you sufficient time to collect receivables without spending money on short term credit lines
- **Take advantage of early payment incentives.** If your suppliers offer you a discount for paying early (usually within two weeks of receiving the bill), take them up on it. Think of it this way: a 2% discount on a 30-day invoice is equal to a 24% annual return if the money was invested. If your suppliers do not offer this kind of incentive, ask for it. They may be willing to offer the discount in return for speeding up their receivables.
- **Balance your client base.** Many service and professional companies such as advertising or PR agencies, accountants, attorneys and real estate management firms, work with certain clients on a project-by-project basis. Look for ways to convert some of these clients to a retainer relationship, where they pay you a set amount of money per month for a certain number of services. You might want to offer them some kind of incentive (value-added services or a discount) to encourage them to shift to a retainer. This might reduce your profit margin, but it will help make your cash flow more predictable.
- **Check your pricing.** Have your prices kept pace with your rising costs? When was the last time you raised your prices? Many small businesses hesitate to increase their rates because they are afraid they will lose customers. However, customers actually expect their suppliers to institute small, regular price hikes. Also, be sure to check out your competition on a consistent basis. If they are charging higher prices, you should too.
- **Do not buy all in one place.** You can save money by splitting your business between suppliers. Closely examine where you need to pay for added service, and where you can save money by paying commodity prices. For example, you might want to buy your computer hardware from a value-added reseller who can help you choose the right system to meet your business needs, while you can purchase other items such as printer cartridges, cables, or off-the-shelf software, online or from another price merchant. To make certain you are paying competitive rates, you should compare the prices of typical office equipment (such as computers and printer supplies) between different suppliers.

- **Form a buying cooperative.** Save money on supplies by rounding up a few colleagues and buying supplies like cd discs, USBs and printer paper in bulk, then dividing them up amongst yourselves.
- **Renegotiate your insurance and supplier policies.** Are you getting the best possible deal on insurance, phone service, and other regular business expenses? Review each of your insurance policies annually and get three quotes for each to ensure you are getting the most for your money. Keep a close eye on price sensitive services such as your long telecommunications or your internet access service. Regularly examine these bills and call around to make sure you are getting the lowest available rate.
- **Tighten your inventory.** Overstocking inventory can tie up significant amounts of cash. Regularly gauge your inventory turns to make sure they are within industry norms. You can do this by calculating your inventory turnover ratio (cost of goods sold divided by the average value of your inventory). Avoid buying more than you know you need when suppliers lure you with big discounts – this can tie up cash. Periodically check your inventory for old or outdated stock, and either defer upcoming orders to use that stock or sell it at cost to improve your liquidity.
- **Consider leasing instead of buying.** Leasing generally costs more than buying, but these costs can often be justified by the cash flow benefits. By leasing computer equipment, cars or other tools you need to expand your business, you will avoid tying up cash or lines of credit that might better be used for running your business day-to-day. Lease payments are also considered a business expense, so the tax benefits are maintained even though the items are not purchased.

Source: www.open.americanexpress.com

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Appendix E
How to Write a Winning Proposal

What is a Proposal?

A proposal is a document generated by a company to obtain funding from another organisation. While a business plan can be considered a proposal for the company as a whole, a proposal generally focuses on a specific opportunity for the business, whether it is a bid for a solicited job, or proposed research and development work.

While business people and innovators may come up with some great ideas, those ideas will simply languish unless they can be communicated in a way that gives them credibility. Proposals are one way that businesses can sell their ideas to organisations that will provide the business with funding. Proposals often have many of the same components as a business plan, just on a more focused level.

Proposals can be written in response to solicitations or grant announcements (requests for proposals, requests for quotations), or can be unsolicited. That is, the organisation proactively approaches organisations that may have funding, rather than waiting for the announcement of a funding opportunity. Solicited proposals are generally more widely accepted because they respond to a need that the soliciting organisation has publicised.

Writing a Proposal

Like a business plan, a proposal requires a significant effort to:

- Effectively address the needs of the soliciting organisation,
- To clearly express the solution brought forth by the proposing business, and
- To prove that the proposing business is the right entity for the job.

A proposal should be written by a group of people within the organisation that meet the various needs of the project. This could include but is not limited to, project management, technical expertise, financial expertise, manufacturing and commercialisation (for product development), and legal counsel.

Proposal Contents

A quality proposal should include (but is not limited to):

- A detailed description of the work to be performed.
- Background of the problem to be solved (if applicable).
- A task-based work plan with schedules and milestones.
- A listing of key personnel, including résumés and descriptions of each person's responsibility within the proposed project.
- Summaries of relevant work performed in the past.
- Information about the company as a whole, showing why the business is the best choice for the job. Include general capabilities, facilities information (if applicable) and relevant assets.
- Information about consultants or subcontractors (if applicable).
- Financial information including overall budget, labour and material costs and other information specified in the solicitation.

Different solicitations will require different content to be included in the responding proposal. It is important to refer to the solicitation or to the point of contact for the exact requirements for each proposal.

Strategies That Can Set Contract Bids Up for Success - or Failure

Business proposals must be highly competitive in a tight economy. Here are 3 elements that, if used wisely, can make a proposal rise to the top of the pile.

A business proposal should always include all the elements that are asked for in the request for proposal, formal or not. However, there are three things that should be considered for inclusion every time a proposal is written because each of them can improve – or detract from – the proposal's chances. These are:

- Testimonials
- Samples
- Graphics

These additional elements can enhance understanding of the information that is being presented and establish expertise or credibility, but they can also make a proposal seem unprofessional or overly glitzy. Do not write a proposal that relies on tricks alone to sell the business's services. Use these elements to enhance value, rather than distract from weaknesses in the business proposal.

Testimonials

Any company that has a track record in its field should not be afraid to ask for a written testimonial to include in future proposals. In fact, a good salesman will make asking for referrals and testimonials part of the sales process. If your clients are eager to help but unsure what to write, provide a draft and ask them to suggest changes before signing it.

Testimonials can be included as an appendix to a business proposal, or quotes from them can be placed in relevant sections of the text. One or two well-written testimonials will make your point better than a dozen gushing letters will. Remember to include the client's full name and company – letters can be more easily faked if names are replaced with initials.

Nothing can solidify a small business reputation like a stack of client testimonials. Savvy consumers rarely make decisions without seeing what their peers think first.

Client testimonials are the cherry on the top of the marketing plan for a small or home business; the words of a satisfied client describing his or her experience. Consumers in the 21st century garner feedback from each other with unprecedented speed through social bookmarking (quick rating of web pages by users), online forums and reviews. Customer testimonials can be collected and used both online and offline to encourage a prospective client on the edge to make a decision to buy.

Types of Written Testimonials

Although containing the same general information, testimonials can be written down on paper or on a computer. Both have advantages to a word of mouth marketing campaign.

Paper testimonials are the oldest form of written testimonial. They can be hung on walls, kept in a "brag book" of work well done, or copied and handed out at lectures and presentations. There is a higher perceived value when a client takes the time to put their thoughts about a business on paper.

Internet testimonials are easier to receive and also easier to falsify. They can be emailed, collected on the business's own website, or written on third-party web pages such as hellopeter.com. Internet testimonials will likely reach far more potential clients than paper testimonials.

Elements of a Client Testimonial

The most credible and compelling testimonials are very specific in their reasons for praising the business. Without specific reasons, it is not likely that the customer would write a letter of praise in the first place, and ideally, they include some of these elements:

- Full name of the customer
- City and province
- Date of the testimonial
- Client signature
- Problem the business overcame
- Example of excellent customer service
- "Before and after" pictures
- Amount of money customer was saved

The more elements a testimonial includes the more believable and interesting it is to potential clients.

Obtaining and Using Written Testimonials

It is never ethical to fake a testimonial, but there is nothing wrong with asking satisfied clients to write them. Unless asked, far more consumers will make a complaint about a business than will praise one in writing. A request can be general (for example, adding the phrase, "If you are satisfied with your experience with us, please drop us a note and let us know" at the bottom of customer receipts or linking to the company's page on a popular review site) or specific ("John, would you be willing to write down how happy you are about your experience?"), but should not offer incentives, as they would dilute the credibility of the testimonial.

- Customer letters can be used extensively to market a business, especially online.
- One suggestion is to include a photograph of the client with the testimonial.
- Paper testimonials may be scanned in. These may be too large to gather together on a page, but the images can be linked to from the web version of the text.
- Testimonials on third party web pages can be distributed widely through the use of social bookmarking.
- Newsletters and e-zines should include a section devoted to customer letters.

Client testimonials strengthen a business reputation and build word of mouth referrals. Consumers understand the value of written recommendations in establishing credibility. Only an ethical businessman skilled at customer service will be able to acquire many written testimonials.

Samples

Providing samples of the business's work in the field can be the best way to show that the company understands the project, and is qualified to complete it. Samples establish clear levels of competency, enhancing credibility in those core areas. A caution about providing samples: if the business's best work in the field won't make it look good, nothing will doom its chances faster. To the discerning business customer, a lack of experience is preferable to a track record of subpar performance.

Graphics

Pictures are worth a thousand words, but leave out graphics that do not have something obvious to add to the proposal. Use illustrations if they will make explaining or proving something easier, but don't waste the client's time by asking him or her to wade through piles of graphs that do not demonstrate anything of interest. A properly designed chart or well-labelled schematic can tell a potential client at a glance if this proposal is going to make the cut. Cluttering up a proposal with charts that do not track meaningful data, or do not have any clear basis for predictions, can cause clients to reach for the next proposal in the stack.

6 Tips for Writing Strong Business Proposals

Focus on Benefits When Responding to Requests for Proposals

Putting together a business proposal for a large contract can seem intimidating or overwhelming, but if your company is right for the job it need not be.

Larger customers, like governmental departments and corporate divisions, often require business proposals in writing for long-term and complex contracts. A written business proposal must lay out, in detail, the steps the bidder expects to take to complete the project on time and under budget. Although the process may seem daunting, many businesses obtain the bulk of their work through business proposals.

When developing a business proposal, keep in mind that the following six tips will minimise the chances for any shortfalls that could lose the contract to a competitor.

- Understand the job. Is there a written request for proposals (RFP) available? This document should explain what the job entails. Restate the scope of the job in the introduction of the proposal so that the client knows right from the start that this bidder is clear on what is being asked.
- Focus on the client. What problem needs solving? For example, if the proposal is to provide group health insurance, the problem may be employee retention. Asking questions to confirm the problem may not be possible during bidding, so competitive intelligence may be required. The focus of the proposal should be on how the client's problem will be solved.
- Make it personal. If the above two points are not sufficient, then make sure that the business's, or owner's, passion comes across in the proposal. A personal connection can make a difference in which proposal is accepted.
- Budget honestly. Most small businesses are more able to compete on value than price. If lowering the bid hinges on expectations of additional work from the same source, consider such factors as likely volume and amount of work, and whether or not it would be billed at the same discounted price. It is often more effective to present a case why the quoted price is a better value. The client should know when a bid is unrealistically low.
- Speak the language. If technical jargon will get the point across most easily, by all means, use it – but always write in the clearest language for the audience. Acronyms and scientific terminology will not make a proposal seem more qualified if the client does not understand the words – he or she is more likely to move to the one that is written plainly. Proofread it. Get as many sets of eyes to read the proposal as time will allow because typographical errors can sink a proposal that is otherwise worthy of consideration. Like résumés, business proposals pile up quickly in a competitive economy, and their reviewers are sometimes forced to make decisions on criteria such as correct spelling.
- Regardless of its size or complexity, a business proposal at its core is a marketing piece, designed to pitch a specific package of services to a particular client. In many cases, the client will even tell you exactly what they would like to see by putting out an RFP (request for proposals). Use this document as a road map to writing a successful business proposal.

Appendix F
Personal Income and Expenditure Statement Template

Where are you now? Use the following income and expenditure statement template (obtained from the Standard Bank of South Africa website) to take a "snap-shot" of your current financial situation – this is also known as a budget. (If you added eleven further columns to this table (one for every month of the year) you would create a cash flow statement!).

Gross Monthly Income	Explanation	Amount
Monthly Salary	This is the gross salary reflected on the payslip or the amount deposited in bank account on regular basis if self-employed.	R
Allowances in cash	Any cash allowance (Provided it can be proven as sustainable and over a period of time.)	R
Commissions	Any commissions earned averaged over 12 months with the first and last month excluded.	R
Investments	Any investment income like dividends or interest income averaged over the year.	R
Maintenance	Any cash received in the form of maintenance.	R
Grant subsidies	Any subsidies received on a monthly basis (i.e. housing subsidies received from your employer).	R
Rental	Rental income received.	R
Pension	Any pension monies received.	R
Other	Any other income.	R
Total gross monthly income	Summing salary income	R
Salary Deductions	**Explanation**	**Amount**
Tax – PAYE / SITE	The amount of PAYE / SITE amount reflected on your payslip. If you are a provisional tax payer then annual statements can be used or it can be estimated per month.	R
Pension	The amount of money deducted each month for pension / provident fund contributions reflected on pay slip.	R
UIF	The amount of UIF reflected on monthly pay slip.	R
Medical Aid	The amount of money deducted for medical aid contributions as per monthly pay slip for the individual.	R
Monthly living expenses	**Explanation**	**Amount**
Insurance premiums	Any insurance premiums e.g. • Household contents insurance • Vehicle insurance • Home Owners Comprehensive Insurance • Cell phone insurance • Funeral insurance • Medical insurance	R
Life assurance premiums	Any Life assurance premiums (including death, disability and retrenchment cover premiums).	R
Electricity and water	Average of 12 months electricity and water bill.	R

Rates ,taxes, and levies	Any rates and taxes or levies.	R
Accommodation rental	Any accommodation rental.	R
Leases	Any lease agreements including rental leases and vehicle leases.	R
Hire purchase agreements	Any HP agreements the customer may have.	R
Telephone and cell phone (including line rental)	Average of 12 months of telephone and cell phone bills.	R
Alimony or maintenance	Any payments in terms of alimony or maintenance that need to be paid on a monthly basis.	R
Planned savings	Any amount that you have planned to save on a monthly basis.	R
Donations	Any donations to charities on a monthly basis.	R
Pocket money	If any funds paid for pocket money.	R
Education - fees, books and accommodation	Any education fees that need to be paid on a monthly basis. Average of 12 months.	R
Clothing	Any clothing expenses excluding clothing accounts paid on a monthly basis.	R
Groceries	The amount paid for groceries on a monthly basis averaged out over 12 months.	R
Medical bills (Doctor and chemist)	Any medical bills averaged on a monthly basis excluding medical aid.	R
Domestic and garden help	Monthly salaries of domestic or garden employees.	R
Security	Monthly premiums for security.	R
Transport	Any petrol, bus fare or parking fees averaged for 12 months excluding any car repayment. If there is a tracker facility, this needs to be added.	R
Entertainment	Any entertainment expenses averaged over 12 months.	R
TV rental, M-Net and DSTV subscription	Monthly subscriptions for TV rentals, M-NET and DSTV.	R
Subscriptions	Any other monthly subscriptions e.g. Internet service provider, Magazine subscriptions, gym fees.	R
Suretyship payments	The monthly surety payments needs to be taken into account only if you have been called upon to honour a surety agreement.	R
Retirement annuity contributions	Any monthly retirement annuity contributions.	R
Funeral plans	Any monthly funeral plan payments other than those specified under Insurance premiums.	R
Retail Store accounts	Any monthly payments made for retail store accounts e.g. Edgars.	R
Other financial agreements	The monthly instalment or payment made on credit cards and other loans like vehicle asset finance or student loans including other home loans still in existence.	R
Other (specify)	Any other living expenses not specified above.	R
Total monthly expenses	Sum of all expenses	R

Section 2: Contract Negotiation

Learning Goals and Pathways

In order to run a successful business and secure finance, you will find it necessary to negotiate deals and contracts.

This section will help you to work through the principles and practice of business negotiation. It is presented in chapters 5-8 of the guide. Note that there are also a number of annexures at the end of section 1, which may be useful tools to help you in the process of seeking and obtaining business finance.

The learning goals for this module include:

1. To understand the need for negotiation skills in business.
2. To understand the steps in the negotiation process.
3. To apply the steps in the negotiation process.
4. To examine strategies that could be used in negotiation.

Chapter 5
Business Negotiation Skills

Why Is Negotiation Necessary?

definition

Negotiation

Negotiation is a dialogue intended to resolve disputes, to produce an agreement upon courses of action, to bargain for individual or collective advantage, or to craft outcomes to satisfy various interests. It is the primary method of alternative dispute resolution.

Negotiation occurs in business, non-profit organisations and government departments, legal proceedings, among nations and in personal situations such as marriage, divorce, parenting, and everyday life.

Negotiation is a process centred on a discussion that is intended to produce an agreement. In its simplest form, it could be considered to be about power. More than just about money, it involves issues of ego, leveraging, saving face, and being right. It can appear that the negotiator or team with the most power will triumph over a weaker team or win something important.

In current business practices, however, negotiation often leads to compromises, where both sides make concessions to get as close as they can to exactly what they want. Other times, no concessions are available and a power struggle can go on for a long time. When negotiation is not effective, there are other options, such as bringing in a mediator, which can help both sides speak to one another and move towards a resolution instead of walking away and resolving nothing.

Business is negotiation. You will negotiate to buy, sell, conclude contracts with suppliers, adjust the staff salaries and so on. What is more, you have to negotiate with regulators, banks and insurance companies. It means that business life is a permanent negotiation with other people who are defending their own interests.

The modern workplace has also changed to one where employees have more of a voice than before. The workplace is no longer a situation in which the manager's word is LAW, but where employees are encouraged to contribute and participate in the decision-making process. We call this the democratisation of the workplace.

However, although a more participatory approach to decision-making in the workplace builds more effective enterprises, it also opens up greater chances of workplace conflict. Every human interaction has the potential for conflict, and when a diverse range of people work together every day, conflict is inevitable. Each person in your organisation will have unique needs, values, desires, and perceptions, and these unique factors may at times cause stress or tension in workplace relationships. The same applies to your relationships with suppliers and clients.

It is important to be able to know how to identify, assess, and resolve these conflicts through negotiation.

information

Game theory

In game theory and economic theory, zero-sum describes a situation in which a participant's gain or loss is exactly balanced by the losses or gains of the other participant. If the total gains of the participants are added up, and the total losses are subtracted, they will sum to zero.

However, the aim of negotiations should be to create something bigger that either of the parties could achieve on their own.

Lower Level Decision Making

Lower level managers may need negotiation skills for the following purposes:

- They may need to negotiate their own salary increases.
- They may need to negotiate with their superiors for better working conditions of their subordinates.
- They may need to negotiate for vacation leave or family responsibility leave.
- They may need to negotiate with suppliers for better prices or products.
- They may need to negotiate with clients regarding amendments that need to be made to a product or service.
- They may need to negotiate with the cleaner to clean their desks.
- They may need to negotiate with their fellow team members to ensure a more equitable sharing of workload on a project.
- They may need to negotiate with the company switchboard operator to hold their calls and take messages while they are in a meeting.

Lower level managers and business managers or entrepreneurs must negotiate with a multitude of people every day. The people with whom they negotiate may be their subordinates, their peers or their superiors. They may also need to negotiate with clients or subcontractors depending on their level within the organisation and their level of responsibility.

practical

Complete the following formative assessment:

F13948.1 – Class Discussion with Key Notes

Chapter 6
The Negotiation Process

Steps in Negotiation

Whether you covet a new job, a raise, a business deal, a new car or the resolution of a business conflict there are six distinct stages to the negotiation process (Craver, 2004):

- Preparation
- Probing – establishment of negotiator identities and the tone for the interaction
- Presentation – information exchange
- Bargaining – exchange of items to be divided
- Closing the deal
- Maximising the joint returns

We will discuss the purpose of each stage and the most effective ways to accomplish the objectives underlying each.

Preparation

There is no substitute for thorough preparation when individuals have to negotiate. Information is power, and the person who is better prepared will exude an inner confidence that is likely to undermine the confidence of their less prepared adversary. People must know the relevant facts, economic issues, and, where applicable, any legal or political issues pertaining to the deal.

Someone planning to purchase a new car needs to know what the dealer paid for the vehicle in question. Someone negotiating the salary for a new job should also do his or her homework. What are similar positions paying? By asking friends in the industry or looking online the candidate can get a good idea of what similar positions are paying. When in doubt, negotiators should always spend extra time making sure they have generated as much information as they can about the matter to be addressed.

When negotiators have gathered all of the relevant information, they have to ask themselves three critical questions.

- First, what happens to their side if no agreement is reached? Negotiators must always remember that bad deals are worse than no deals when their non-settlement alternatives would be preferable to what they have agreed upon.
- Most negotiators ask this initial question to determine their bottom line, but they fail to ask the second part of this question. What happens to the opposing party if he fails to reach an agreement with you? It is imperative for negotiators to place themselves in the shoes of the other side and estimate what would probably happen to it if they did not achieve an agreement with this side. People who only know their own bottom line generally behave as if their opponents have no pressure to settle, and they concede all of the bargaining power to their adversaries. If the opposing side's non-settlement alternatives are worse than this party's, that side has more pressure to settle, and this side possesses more bargaining power.

- Once a negotiator has determined their own and their opponent's bottom lines, they have to establish their own aspiration level. How well do they think they can do in this negotiation? There is a direct correlation between negotiator goals and bargaining outcomes. People who want better deals, get better deals. It is thus important for individuals preparing for bargaining encounters to establish firm, but realistic, goals they can use to guide them during their interactions with the other side. When multiple items are to be exchanged, it is imperative for people to create goals for each item. If they only have objectives for some, but not all, of the items to be exchanged, they will readily give up the items for which they have no firm aspirations. They should establish comparative values for the different items involved. Is issue A valued three times as much as issue B or only twice as much? How much of issue A must this side obtain before it is basically satisfied with respect to that term? For example, a car seller may really need to obtain R 12,500 but would like to get more. If they can get R 14,000, they would not be willing to risk a no-sale over the possibility of obtaining an additional R 500 or R 1,000.

When negotiators get into the interaction with the other side, they must remember to focus on their objectives, not their bottom lines. People who concentrate on their bottom lines tend to relax once those minimal objectives are achieved. Astute opponents will read their nonverbal signs of relief and not be too forthcoming after that point. Skilled negotiators always keep their eyes on their aspirations and do not relax until they approach those targets. This induces others to think they have to offer better deals to get them to accept the terms being proposed.

Deciding Where to Start

Negotiators must establish where they plan to begin the interaction. Some people naively suggest that negotiators begin with reasonable opening offers to create a win-win bargaining atmosphere that will be reciprocated by their opponents. This is a lovely thought, but not empirically supportable. Because of a phenomenon known as "anchoring," when negotiators begin with generous opening offers, adversaries begin to think they will do much better than they initially anticipated, and they raise their expectation level to take advantage of the situation.

On the other hand, when people receive less generous opening offers, they begin to think they will not do as well as they hoped, and they lower their expectations. Negotiators should thus try to establish the highest demand or lowest offer they can rationally defend. How much can they logically request or how little can they reasonably offer? By beginning further away from where they hope to end up, they begin to undermine the confidence of their opponents. On the other hand, if they began with offers more generous to the other side, they would embolden that party and cause it to expect more generous final results.

Gain-Loss Framing

Negotiators should also be aware of the impact of "gain-loss framing". Persons offered a certain gain and the possibility of a greater gain or no gain tend to be risk averse.

They prefer the sure gain to the possibility of nothing. "Who wants to be a Millionaire" provides a perfect example. Once contestants get to R 125,000 or R 250,000, they know that if they miss the next question, they will fall back to R 32,000. Unless contestants are quite sure they know the answer to the next question, they usually take the amount they have already earned and depart. On the other hand, individuals facing a certain loss and the possibility of a greater loss or no loss tend to be risk takers in an effort to avoid any loss.

example

Gain-Loss Framing

Assume that you are in a room with 100 people. You are told that everyone who goes out one door has to pay R 100. Four out of five people who go out of another door have to pay nothing, but one out of five going out that door has to pay R 500. Most people offered this choice elect to leave by the door where there is a four-in-five chance they will not have to pay anything despite the fact they have a 20% chance of being charged R 500.

When individuals prepare for bargaining encounters, they should formulate offers that will look like sure gains to their opponents. They may offer the other side money or something else of value that will cause most adversaries to become risk averse. What if they have to ask for something of value from the other side to resolve a controversy? They should try to make it seem that for what they are seeking the other side's problem will be resolved. If they seem to be offering the other side a sure loss, it might become risk taking to avoid any loss, but if they can induce the other party to think they will obtain a gain for their payment, they will become risk averse and look for a mutual accord.

Once negotiators have established their bottom lines, their aspiration levels, and their opening offers, they should take the time to choreograph their impending interaction. How do they visualise moving from where they begin to where they hope to conclude their interaction? Do they plan to make several larger position changes or a number of smaller position changes? Which negotiation techniques do they anticipate using? The more they plan their impending interaction, the more they are likely to achieve their objectives. Negotiators who fail to plan adequately are likely to give in to their more prepared adversaries.

Establishment of Negotiation

Once people have thoroughly prepared for their bargaining encounters, they begin to interact with their counterparts. When people commence bargaining encounters, they are generally anxious, because they have no way of knowing whether their efforts will be successful. If they begin the substantive discussions in this frame of mind, their anxiety may adversely affect their relationship with the other side and undermine the actual discussions. To diminish this possibility, it is helpful for people beginning bargaining interactions to take the time to establish some rapport and create positive environments.

The Preliminary Stage

Proficient negotiators use this preliminary stage to exchange small talk and get to know each other. They may discuss sports, politics, weather, mutual acquaintances, or other seemingly innocuous topics. It is helpful to look for areas of joint interest because familiarity makes people more likeable. This part of the process may only take a few minutes, or it may go on for hours. Sometimes it can go even go on for days when international negotiations are involved and persons from different cultures are endeavouring to establish both rapport and trust.

Another reason for a thoughtful preliminary stage concerns the impact of the negotiator's mood on bargaining encounters. People who begin interactions in positive moods behave more cooperatively, are more likely to generate mutual accords, and to achieve efficient agreements, while individuals who begin in negative moods behave more competitively, reach more bargaining impasses, and attain less efficient terms. It thus helps for negotiators to work together to generate positive bargaining environments that should contribute to their joint success.

The final portion of the preliminary stage is used to establish mutually beneficial bargaining atmospheres. Cooperative / problem-solving negotiators tend to cooperate with others, while competitive / adversarial negotiators tend to compete with others. Difficulties are likely to arise when cooperative / problem-solvers interact with competitive / adversarial opponents. If the cooperative people are too open and trusting, they will give an advantage to their less open and more manipulative adversaries. To avoid such exploitation, the naturally cooperative negotiators must behave more strategically, in other words, be less open and less trusting until they are certain their openness is being reciprocated. When they encounter competitive opponents who are not as open, the cooperative persons must be less open with their critical information to avoid a one-way information flow favouring their manipulative adversaries.

Information Gathering

As the small talk declines and the parties begin to think about the substantive issues to be negotiated, they move from the preliminary stage into information gathering. Each side focuses on the other as they try to determine what terms should be addressed. The best way to obtain information from others is to ask questions. Individuals who issue declarative sentences give up information, they do not obtain it. People who wish to get new information know how important it is to get the other side talking. The more they speak, the more information they disclose. The best way to accomplish this objective is through the use of broad, open-ended questions that cannot be answered by short responses. Most negotiators think their opponents know more about their particular situations than they actually know. As a result, when they respond to expansive inquiries, they inadvertently disclose details they think the other side already knows. Negotiators should only begin to narrow their questions once they think they have a good picture of the other side's circumstances and they are trying to confirm what they think they have been told.

Verbal Talks

During the information exchange, questioners must listen carefully for verbal leaks that disclose important information. For example, someone may initially indicate that they "have to have Item 1," they would "really like to get Item 2," and they "want Item 3." Item 1 is critical because they have to have it. Item 2 is important – they really wish to obtain it – but it is not essential. Item 3 is only desirable. They would trade it for an important or critical term.

What if someone indicates that they are not inclined to go above or below X or they do not wish to move? These verbal clues would suggest that they would actually do so if the listener gives them time to do so. This is like the negotiator who gets near the end of an interaction and says they do not have much more room or are not inclined to move further – both of which indicate their actual willingness to make additional concessions.

What information is this side willing to disclose and how should they divulge it? If important information is voluntarily disclosed, it tends to be devalued by opponents who assume it is self-serving. Negotiators who want opponents to value their information should make them work to obtain it by divulging these items slowly in response to adversary questions. The more the questioners have to work to obtain this information, the more they value what they hear.

Information Exchange

During the information exchange, participants should try to discover what items each side prefers to obtain. A common error made by less proficient negotiators is to assume a fixed pie to be divided by the parties. In most cases, especially multiple item exchanges, the parties value the items differently. One side may desire some terms not particularly valued by the other side, and vice versa. These items should be given to the party that wants to get them. Even when both sides may want the same items, their preferences may differ. As a result, side A may really need items 1, 2, and 3, while side B may have to get items 4, 5, and 6. If side B gives side A the former terms and side A gives side B the latter terms, both can gain simultaneously. There will then be some items that both sides value equally. These are the distributive terms the parties will fight over. In the end, some will go to side A and some will go to side B. By looking for ways to expand the pie and simultaneously enhancing the returns to both sides, negotiators improve their own situations.

Distributive Stage

Near the conclusion of the information exchange, the focus changes from the other side back to our own sides. Negotiators stop asking the other party what it wants and begin to state what they must obtain or what they are willing to give the other side. At this point, they enter the distributive stage. The information exchange involves value creation, as the parties try to determine what they have to divide up, while the distributive stage involves value claiming, as the parties try to obtain items for themselves. This is a highly competitive part of bargaining exchanges, with both sides seeking to advance their own interests. Individuals who naively ignore the competitive aspect of this stage are likely to lose to manipulative opponents who seek to maximise their own returns.

It is important for people to have firm goals and set bottom lines before they enter the distributive stage. They should have planned concession patterns they think will lead them to the results they desire. How do they visualise a series of position changes that will conclude with good deals for themselves? Should they make the first offer or try to induce the other side to do so? If business partners or close friends are negotiating over something with a defined and relatively narrow settlement range, going first can be an advantage. By beginning with an offer just inside the settlement range, the other side may consider the offer fair and accept the terms being offered.

In most other situations, it is usually beneficial to get the other side to make the first offer. If one or both parties have miscalculated the value of the deal to be negotiated, the side going first will disclose the mistake. The other side may be more generous than this side anticipated, and it can now take advantage of that situation. The second reason for getting the other side to go first concerns "bracketing." Once one side makes an initial offer, the other can start far enough away from that point to place its goal in the middle of the initial positions. Parties tend to move from their opening positions toward the centre. By getting the other party to make the initial offer, this side can start with an offer that places its objective near the midpoint of their positions.

Underlying Positions

During the distributive stage, the participants should go behind the stated positions and look for the interests underlying those positions. Why does one side want a particular item? If it could not obtain this term, are there other ways this side could satisfy that party's real needs? When emotional disputes are involved, the participants often demand extreme terms to satisfy their desire for revenge. What they really want is recognition from the other side for the plight they have suffered. An easy way to disarm such a party is through the use of an apology. If this side indicates how sorry it is that the other side has suffered a loss or indicates how sorry it is that the other side feels the way it does, it has gone a long way toward settlement. This may diminish the emotional tension and allow the parties to focus on ways to solve their conflict.

Current Non-Settlement Alternatives

Throughout the distributive stage, negotiators must always know their current non-settlement alternatives. It does not matter what their options were six months or a year ago – it only matters what they are now. As they approach their bottom lines, they should also appreciate the fact that they actually possess more bargaining power at this point, since the difference between a poor deal and no deal becomes less significant. As they approach their own bottom line, they should realise that the other side must be doing quite well. Which side has more to lose from a non-settlement – them or their opponents? It is their adversaries who may forego a good result for a less beneficial non-settlement while they would only risk a poor agreement for an equally onerous non-settlement.

Concession Patterns

During the distributive stage, negotiators should focus on the concession patterns. They should avoid two tendencies of less proficient negotiators. First, the willingness to bid against themselves through unreciprocated concessions. Once a position change has been made, it is the other side's turn to respond. If it fails to do so, this side should not make another concession. Second is the tendency of less skilled participants to make excessive position changes. Negotiators should always monitor concessions to be sure their position changes are not larger than those being made by the other side. If they have initially "bracketed" their goal and move in similar increments toward the centre of their current positions, they will often obtain the final terms they desire.

Closing the Deal

Near the end of the distributive stage, the parties see an agreement on the horizon, and they enter the most delicate part of their interaction. Less competent negotiators want so badly to conclude the transaction that they move quickly toward agreement and close most of the gap remaining between the parties. Human beings like certainty, and when they see the certainty of an agreement ahead of them, they want to solidify the deal and move on to something else. Participants who get this far need to realise that a final deal is going to be achieved, but they should not rush the process.

The closing stage is the time for calm and deliberate action. Both sides want to solidify the deal, and the party that is more anxious tends to close more of the remaining gap. During this part of the interaction, participants should be careful not to make unreciprocated concessions. They should try, however, to induce their opponents to do so by making it seem that the only way to conclude the deal is for the other party to move toward them. By exuding an inner patience that disconcerts a less patient opponent, this side may generate consecutive position changes by the other party.

Once many parties conclude the closing stage and reach a tentative agreement, they shake hands and end their interaction. Individuals who do so often make a critical mistake. They fail to be certain that they have maximised the joint return achievable by the parties. During the information exchange and the distributive and closing stages, the parties have over- and understated the value of items for strategic purposes. As a result, different terms may have ended up on the wrong side of the bargaining table. The cooperative stage is the time to rectify these inefficiencies.

When a tentative agreement has been achieved, the parties should acknowledge their accord and resort to cooperative bargaining. They want to see if they can expand the pie and simultaneously improve their respective situations. They hope to achieve a Pareto (80% effects from 20% causes) superior agreement where one party could not gain without the other suffering a loss. One or both participants can suggest possible trades they think will improve their joint returns. They have to look for the items that may have ended up on the wrong side of the table and exchange them for terms the opposing side values more. Divorcing spouses may have agreed upon joint custody of the children when one would prefer primary parenting responsibility which the other would accept in exchange for generous visitation rights and other concessions. An employer may have just agreed to cover a new worker's moving expenses even though the employer of that person's spouse will cover these expenses. It would thus be beneficial for the new employee to forego the moving expenses in exchange for a different benefit of comparable cost to the firm.

To maximise the effectiveness of cooperative bargaining, negotiators must follow two basic rules. First, if someone wants certain items, they must inform the other side of their desires in this regard. If they are so coy that they fail to apprise their opponent of their wish to obtain these terms, the other party may never appreciate their interest in this regard. Second, if the other side has requested items this side does not particularly value before the negotiators conclude their interaction, this side should ask the other party what it would trade for the terms in question. The negotiators want to be sure they have not left party satisfaction on the bargaining table by failing to maximise their joint returns.

Negotiations Failure

While volumes have been written on negotiating tactics, techniques, and strategies, relatively little is written on the reasons negotiators fail to achieve their stated goals and objectives. Three reasons are discussed here:

The first, and perhaps most essential reason, many negotiators fail is that the great majority of negotiators never translate their general knowledge of negotiation into specific skill (s) that can be called upon with the same simplicity as the multiplication tables.

Why is it that so many who would agree that the memorization of the multiplication tables is an important step prior to the study of algebra see no bearing in committing the basic principles of a specific negotiating framework to memory as a basic part of establishing themselves as expert negotiators?

The idea is to develop a thorough understanding of a specific type of negotiation model, to use it repeatedly, and then be able to understand clearly from there, where a negotiation failed or succeeded. If you do not really understand the specific principles in a particular negotiating model, you cannot teach it to anyone, and you cannot determine where a negotiation went wrong or not (so that you can repeat that success or avoid that failure in future).

Think about it: What happens when the end result of a negotiation is not one that you want to duplicate? How can a negotiator ever aspire to understand where a particular negotiation went off track if that negotiator was never certain which track the train was on in the first place? Simply put, the vast majority of professional negotiators do not have a clue where their unsatisfactory negotiations went wrong or how to avoid similar mistakes in the future. And it is precisely because they are missing a specific negotiating foundation from which to analyse their strategy or tactics.

If you get to know a particular negotiation strategy really well, the resulting insight and knowledge is, in fact, your expertise. Your ability to make comparisons about a negotiation process once it is complete, consistently, and under an assortment of circumstances, is your skill.

Building your negotiating expertise by committing to and then sticking with a particular framework of negotiation until you've learned the fundamentals of that framework will split you from the vast majority of professional negotiators. It will also significantly enhance the level of success you are capable of achieving in your negotiations and ensure that you will avoid the first fundamental reason many negotiators fail.

The second fundamental reason negotiators fail is that the majority of negotiators focus on what they believe their starting positions are rather than focusing on the preferred outcome. Keep the end in mind. In other words, far too many negotiators focus on the weaknesses or strengths of their starting positions rather than focusing on the accurate assessment and quantification of the real challenges and issues standing between themselves and their counterparts.

One of the most vital skills a negotiator can develop is the skill of knowing how to assess and quantify the real issues that stand between the parties, rather than acting or reacting based on a perception of what one believes those issues to be. This is one of the most important concepts taught by authorities such as Dr Chester L. Karrass, author of Give and Take, and yet even many experienced negotiators make the error of overestimating or underestimating their strengths and weaknesses - and the positions, strengths, and weaknesses of their counterparts.

Learning to accurately assess and quantify the apparent and hidden issues between the parties involved in a negotiation is a skill that necessitates disciplined focus and a systematic approach as precise as reading braille or deciphering Morse code. To do it consistently and with great accuracy requires more than a measure of good luck and a handshake, because, as Karrass says, "In business as in life you do not get what you deserve; you get what you negotiate."

The third fundamental reason negotiators fail is fear. No matter how much you know about negotiation or about the strengths and weaknesses of your counterpart, if you are missing the courage, discipline, and determination to act in the face of risk or uncertainty, you will frequently fall short of achieving the best possible outcome in a given situation. Fear will always invite you to aim for less than you are capable of achieving. Fear vehemently discourages negotiators from pursuing what M. Scott Peck calls "The Road Less Travelled," which is exactly the road that must be travelled in order to mould agreements that truly reflect and protect the interests of all parties involved (if that is your objective). If you are engaged in a competitive struggle where your primary objective is simply to prevail, then fear must be conquered first - or you risk being defeated by it long before you are defeated by your counterpart at the negotiating table.

Defeating fear requires a genuine commitment, a methodical process, and a journey beyond the borders of flawlessly executed tactics and techniques.

Anyone can become a significantly better negotiator quickly and systematically by removing these three fundamental reasons negotiators fail.

- First, identify and commit to one of the internationally recognised frameworks of negotiation and thoroughly review and memorise the main tenants of that framework until they are second nature to you. In other words, go an inch wide and a mile deep in one framework of negotiation rather than go a mile wide and an inch deep in many different frameworks of negotiation. Slowly, you will increase your skill, knowledge, and expertise.

- Second, cultivate an ability to identify, assess, and quantify the obvious and hidden issues that separate the parties at the beginning of a negotiation, and then focus on accomplishing your desired outcome rather than your perceptions of the positions, strengths, and weaknesses of the other parties.
- Finally, eliminate fear by moving beyond negotiating: From fear to fearless and you will immediately obtain greater success and greater consistency in your negotiations than you ever thought possible.

Rules of Negotiators

Rule 1: Attitude

Rule 1.1: Everything is negotiable all of the time.

Attitude is critical. Novice negotiators do not understand that everything is negotiable all of the time. They give up too easily. If you slam your briefcase and walk out of a negotiation session, they do not understand that this is a tactic; they interpret it as the end of the negotiation.

Many attributes go into making a skilful negotiator, including such things as having a good memory, being quick verbally, and handling stress well. But effectiveness is as much a matter of attitude as it is of ability. The best negotiators exhibit four key habits of thought that everyone, regardless of their style or IQ, can adopt to improve their negotiation results.

- A willingness to prepare
- High expectations
- The patience to listen
- A commitment to personal integrity

Rule 1.2: Compromise is omnipresent.

Master negotiators are always on the look-out for an acceptable compromise, especially as the gap between the parties, narrows. Assume that you will end up in the middle, between the two opening negotiation positions. In little and in big things, we end up splitting the difference.

Rule 1.3: "Fair" is a range.

Many negotiations break down because one person has a number in mind (his "bottom line"), and the other person has a number in mind, and one or both parties adopt a negative attitude about closing the gap. One way that master negotiators avoid stalemates (impasses) like this is to understand that reaching agreements with people is rarely such an exact science that we can get things down to decimal points. Whether you are trying to settle a personal injury case, buy or sell real estate, or arguing over a premarital agreement, rare is the book that says what the thing is worth. How much will the court award? How much would another buyer pay? How much would another future spouse want? And, if the solution to the various problems over which we typically negotiate were so easily found, there would be no reason to negotiate. Thus, by the very nature of the beast, the "fair" resolution in every negotiation, the elegant solution, is a range, not a point in space. By keeping this in mind, master negotiators are more flexible than novices.

When you negotiate, look for the favourable middle ground where your client is pleased with the resolution and the other party is satisfied enough to do the deal.

Rule 2: Communication Skills

Rule 2.1: Lines of communication are critical.

Without lines of communication, there can be no negotiation. Therefore, this rule is essential. Lines of communication are the life-blood of a negotiation. Master negotiators understand this; novices do not. Novice negotiators often focus on static elements of the problem, believe that they are "playing a winning hand", and throw down the gauntlet, only to learn later that the dynamic elements of the situation have changed, their leverage has withered, and they have burned their bridges.

Master Negotiators nurture their lines of communication. Where lines are weak, they seek to develop new lines.

To ease the stress of negotiating and improve the chances for a successful result, establish rapport with your opponent, and build on that foundation. This is especially important in cases where the parties will have a long-term relationship after closure.

What is the secret to creating and sustaining trust in negotiation? A simple but sturdy norm in human behaviour: the norm of reciprocity. (I do something for you, you do something for me).

Boiled down to its essence, the norm of reciprocity in negotiation amounts to a simple, three-step code of conduct. First, you should always be trustworthy and reliable yourself. Second, you should be fair to those who are fair to you. Third, you should let others know about it when you think they have treated you unfairly. Unfair treatment left unnoticed or unrequited breeds exploitation, followed by resentment and the ultimate collapse of the relationship.

Generosity creates generosity. Fairness creates fairness. Unfairness ought to create a firm response. That is the norm of reciprocity in relationships: Always take turns. After you make a move, wait until the other party reciprocates before you move again.

Another time-tested way to encourage the delicate process of establishing trust in working relationships is to give the other side something as a symbol of good faith. Behavioural economists have argued that gifts, especially gifts between unrelated strangers, often serve as signals regarding intentions to invest in a future relationship.

If you find it hard to establish rapport with the unreasonable, rude person on the other end of the phone, do not give up. There are a couple of things you can do. First, consider an "end run". For example, if you are an attorney, and your opponent is an attorney, and you find it impossible to communicate with him or her, consider having your client communicate with his client. Second, consider employing a mediator. Third, consider engaging another lawyer who you know has good rapport with your opponent.

The best time for handling "people problems" is before they become "people problems". This means building a personal and organisational relationship with the other side that can cushion the people on each side against the knocks of negotiation.

"People problems" fall into three categories: perception, emotion, and communication.

Facts, even if established, may do nothing to solve the problem.

They counsel us to "put yourself in their shoes".

The ability to see the situation as the other side sees it, as difficult as it may be, is one of the most important skills a negotiator can possess. To accomplish this task you should be prepared to withhold judgment for a while as you consider their views.

Seek your opponent's advice concerning how to resolve the issue. You probably will not like what you hear, but he or she will feel better about you because you inquired.

Apart from the substantive merits, the feeling of participation in the process is perhaps the single most important factor in determining whether a negotiator accepts a proposal. In a sense, the process is the product.

This rule suggests that intimidation tactics are ineffective, which, of course, is not true. Master negotiators understand, however, that persuasion is usually superior to intimidation as a negotiation tactic. If intimidation "works", it only works when the negotiating playing field is skewed for some reason, where one party has so much greater leverage than the other, that the interaction can scarcely be called a "negotiation". And, as every parent who has raised a child to adolescence knows, intimidation almost always results in passive-aggressive behaviour and resentment.

Rule 2.2: Be cooperative, but do not let your guard down.

Statistics show that cooperative negotiators are more effective than competitive negotiators. To negotiate well, you do not need to be tricky. But it helps to be alert and prudent. The best negotiators play it straight, ask a lot of questions, listen carefully, and concentrate on what they and the other party are trying to accomplish at the bargaining table.

The master negotiator studies the terrain before settling into a negotiation. He understands that some negotiators are cooperative and some are competitive. Being too cooperative with a highly competitive negotiator is a good way to lose the negotiation.

Pursuing a soft and friendly form of positional bargaining makes you vulnerable to someone who plays a hard game of positional bargaining. In positional bargaining, a hard game dominates a soft one.

Rule 2.3: Listen.

It is hard to overstate the importance of listening skills in bargaining. The best negotiators ask questions, test for understanding, summarise discussions, and listen, listen, listen. You often get more by finding out what the other person wants than you do by clever arguments supporting what you need.

Perhaps the best strategy to adopt while the other side lets off steam is to listen quietly without responding to their attacks, and occasionally to ask the speaker to continue until he has spoken his last word. In this way, you offer little support to the inflammatory substance, give the speaker every encouragement to speak himself out, and leave little or no residue to fester.

Listen actively and acknowledge what is being said. It has been said that the cheapest concession you can make to the other side is to let them know that they have been heard. Standard techniques of good listening are to pay close attention to what is said, to ask the other party to spell out carefully and clearly exactly what they mean, and to request that ideas be repeated if there is any ambiguity or uncertainty. ... Unless you acknowledge what they are saying and demonstrate that you understand them, they may believe you have not heard them.

Rule 2.4: Pare down large groups.

Every negotiator confronts situations where each side is a committee, rather than an individual. This usually means negotiations within negotiations, as the members of each committee or group have to negotiate an intra-consensus before responding to the other side. If every member of every group has to put in his two cents before you can respond to a proposal, the process is slow and tedious. This problem can often be remedied if each group will appoint a representative.

No matter how many people are involved in a negotiation, important decisions are typically made when no more than two people are in the room.

Rule 3: Planning

Rule 3.1: Develop a flexible negotiation plan.

You need to approach each negotiation with a well-conceived game plan. Master negotiators develop strategies for each phase of the negotiation process: opening, middlegame, and endgame. Like master chess players, they come to the table knowing how they are going to open. They understand that, from there, strategies have to be flexible because how their opponents respond to opening offers is unpredictable. Nevertheless, they plan ahead as much as possible.

Freund suggests the follow simple format for developing a negotiating plan:

- What do I want?
- Where do I start?
- When do I move?
- How do I close?

While a novice negotiator may do some planning, he does not plan thoroughly. For example, a master negotiator will always develop a closing strategy. He knows whether he wants to close sooner rather than later and whether he wants extensive documentation, or if an outline of the deal will do.

Rule 3.2: Plan your first move carefully.

Initial offers define the parameters of the "negotiation zone". The negotiation zone is that range in which negotiators bargain. In every negotiation, the parties define the negotiation zone. You get to decide where one end of the zone is located, and your opponent decides the other end. Master negotiators understand that where leverage is relatively equal, there is always a tendency to meet in the middle. Where the middle is ultimately located depends on where they start. Therefore, they put a lot of time and energy to developing and justifying their initial offers.

As a rule, negotiators lead richer, fuller, more rewarding lives than non-negotiators. That's because in reaching for more, they almost always get it.

Master negotiators make the highest (or lowest, as the case may be) first offer they can justify while being careful not to go beyond that point. One of the cardinal rules of power negotiating is you should ask the other side for more than you expect to get. What you should be asking for is your MPP - your maximum plausible position.

Research on setting goals discloses a simple but powerful fact: The more specific your vision of what you want and the more committed you are to that vision, the more likely you are to obtain it. Research on negotiation confirms that anyone who is willing to take the time to develop higher expectations will do significantly better and do so without putting his relationship or reputation with others at risk.

A general approach to the opening proposal lies well between the extremes of outrage and undue moderation. Make a first offer that is sufficiently reasonable to be viewed constructively by the other side and thus evoke a positive response. On the other hand, it should give you enough room to move deliberately to your expectation without being forced to stretch.

Justification is critical. Having a reason for every element of the offer greatly enhances its chances of success. Research indicates that if you ask someone for a favour, he or she will be more likely to do it when you give him a reason.

To avoid appearing arbitrary, express a rationale for your position. Negotiating often comes down to a battle of strength. The more logical your arguments in support of a point, the greater your chances of resolving it on satisfactory terms. The starting point you select should always be defensible.

Never put a figure on the table that you can't back up with a plausible rationale. The harder it is to come up with logic to support your position, the more you have to back into reasons that leave you feeling uncomfortable, the more concerned you should be that your counterpart will perceive your position as overreaching. So, developing a rationale furnishes a useful litmus test to determine whether the position you are taking is defensible.

Rule 3.3: Goals are more important than bottom lines.

What is the practical effect of having your bottom line become your dominant reference point in a negotiation? Over a lifetime of negotiating, your results will tend to hover at a point just above this minimum acceptable level. With experience, you should be able to keep both your goal and your bottom line in view at the same time without losing your goal focus. Research suggests that the best negotiators have this ability.

Your goal is only as effective as your commitment to it. You should make sure it is justified and supported by solid arguments.

Rule 3.4: Plan to make concessions.

Making concessions triggers the law of reciprocity. When you make a concession, the other party will usually respond with one. Indeed, he will feel compelled to do so. The flip side of this rule is that when you do someone a favour, they will feel indebted to you for it.

You are not going to prevail on all issues that arise in a negotiation, so save yourself for the significant ones. Let your counterpart take home a few trophies too, especially on issues that are not that important to you or where the point he is making is unassailable.

There is a vital psychological dimension here. Each party needs to experience the satisfaction of seeing the other side move, in order to feel that the resulting agreement has been adequately bargained. Your refusal to budge will leave your counterpart with a nagging sense of having failed as a negotiator, an ominous mindset that is potentially hazardous to the deal.

Rule 3.5: Understand when and how to mediate.

Master negotiators know when a mediator will facilitate settlement and when a mediator is unnecessary. Master negotiators know when arbitration is preferable to going to court.

Novice negotiators wait too long before employing a mediator. They let problems fester and parties become too invested in their positions. By the time they get around to mediation, they have wasted considerable resources and the momentum toward trial is formidable. The time to mediate is as soon as the negotiations break down, in cases where the parties employ a mediator out of necessity, or as soon as all parties have enough information to bargain intelligently, and in cases where they are mediating by choice (because that is their preferred method of negotiating).

Master negotiators are usually master manipulators, and mediation is no exception. Novices come to mediation and act combative with the mediator or exclude the mediator from all relevant discussions, relegating the mediator to the function of courier. Master negotiators understand that the mediator can help them sell their proposals. They arm the mediator with persuasive arguments, legal briefs, or material evidence in support of their proposals. They add a dash of charm and encourage their clients to endear himself or herself to the mediator.

Rule 3.6: Have a theme.

Lawyers who argue their cases to juries know the importance of having a simple, unifying theme. Johnnie Cochran's theme in the O.J. Simpson murder trial of "if it doesn't fit, you must acquit" is a sound example. Master negotiators understand that this same technique works in negotiations.

A positioning theme is a crisp, memorable phrase or framework that defines the problem you are attempting to solve in the negotiation.

Rule 4: Evaluation

Rule 4.1: Look beneath the surface.

Novice negotiators focus on facts, dollar amounts, legal issues or personalities. Master negotiators understand that every negotiation is a combination of these factors, as well as others.

Skilled negotiators see more than just opening offers, counteroffers, and closing moves when they look at what happens at the bargaining table. They see psychological and strategic currents that are running just below the surface. They notice where the parties stand in terms of the reciprocity norm. They look for opportunities to use what psychologists call the consistency principle to commit other parties to standards and then hold them to their prior statements and positions, and they know that the timing of a proposal is always as important as its content.

So when you formulate your goals, consider carefully what really matters to you. Sure, money is important. But identify your underlying interests and needs clearly.

Rule 4.2: Break the problem up into issues.

Every negotiation involves one or more problems, or "issues", which can be sub-divided when necessary, to make the negotiation more manageable and to allow for partial agreements.

If there are multiple issues, look for trade-offs.

You gain credence for your inflexibility on a few choice issues by your willingness to give ground on the rest.

The method of principled negotiation developed by the Harvard Negotiation Project is to decide issues on their merits rather than through the haggling process focused on what each side says it will do and will not do. It suggests that you look for mutual gains wherever possible and that where your interests conflict, you should insist that the result be based on some fair standards independent of the will of either side. The method of principled negotiation is hard on the merits, soft on the people.

Rule 4.3: Look for multiple solutions.

Master negotiators do not look for the truth or the right answer. They explore options. They know that there are usually a number of workable solutions to the problems that vex us in our social interaction. Finding out what those solutions are may take a little work, and, even though a solution may be workable, it will not necessarily be palatable to everyone. Nevertheless, master negotiators know that, once they get an understanding of the whys and wherefores of each party's "positions", more often than not, there will be several options for bridging the gap, solving the problem, or resolving the issue.

Effective negotiators care about being fair, but they also are assertive about their goals. They push the other party to find the best solutions, not just the simplest compromises.

Rule 4.4: Evaluate people, interests, options, and criteria.

- People: Separate the people from the problem
- Interests: Focus on interests, not positions
- Options: Generate a variety of possibilities before deciding what to do
- Criteria: Insist that the result be based on some objective standard

Begin your preparation for negotiation by considering your own underlying needs and interests. Many people fight over money. However, money usually symbolises something else. Is "feeling like a winner" what it is really all about? Is it feeling like you are being treated fairly? Look behind the money. You will find a lot of solutions there.

Begin your preparation for negotiation by considering your own underlying needs and interests.

Rule 4.5: Evaluate the leverage.

The first basic skill of smart negotiating is an awareness of the leverage factors at work, plus the ability to apply leverage when it is in your favour and make do when it is not.

Leverage is negotiating power, plain and simple. It is the gas in your tank. If you have no leverage, you are at the mercy of your opponent. Master negotiators understand leverage. They know how to develop it and use it to maximum advantage. They know that if they do not use it when they have it, it may not be worth as much tomorrow. Leverage has a way of evaporating. Master negotiators understand that leverage is wonderful, but if you do not use it, you will probably lose it.

Common leverage factors include necessity, desire, competition, and time. These factors usually come along with the deal – they are intrinsic to it. If someone steals your car, and you need another right away, you have less leverage than the person who can wait a month or two to see if the market will soften. If you fall in love with a Porsche, you have less leverage than the person who can live without one. If three people want to buy your house, you have a lot more leverage than if no one will even stop to look. If you have to get that premarital agreement signed because the wedding is tomorrow morning, you do not have as much leverage as you did a month ago.

It is the ability to walk away from the table if acceptable terms cannot be worked out that puts backbone into your bargaining posture.

Because leverage is rarely static, you can usually enhance your leverage, or develop leverage where you had none, through:

- Preparation
- Information
- Number-crunching
- Understanding your opponent

- Exploring and developing other options
- Timing
- Patience

The research on the importance of preparation is extensive. Nearly every research study on negotiation has confirmed its importance.

Good negotiators are patient, exercising a healthy dose of self-control. The most common mistake is giving in to a sense of impatience, satisfying the need many of us feel for instant gratification.

In fact, if we were searching for the definition of the novice negotiator, we could simply say that he is one who ignores leverage. While he knows something about the problem, he is relatively unprepared. He is either scared to crunch numbers or is inept in that regard. He gives little thought to his opponent. He fails to explore and develop other options. He does not consider the timing of his proposals or responding to the other party's proposals. He does not exhibit the patience required to close the deal.

Master negotiators crunch numbers. They know the actual costs of doing the deal and the actual costs of not doing the deal. They can calculate present values if need be. And, they understand the tax consequences of the transaction.

Rule 4.6: Consider the "consistency principle".

Master negotiators understand the "consistency principle", which states that we all have a strong psychological need to be consistent with our prior acts and statements. If you are looking for tactics you can use to manipulate your opponent, consider trying to hook him with some small commitment and then following up with a larger request.

The goal of the consistency trap is to pre-commit you to a seemingly innocent standard and then confront you with the logical implications of the standard in a particular case - implications that actually turn out to run against your interests. This is a form of intellectual coercion, and you should be ready to defend against it.

For example, if you are in a negotiation over child support, and you represent the mother seeking child support above the norm, consider asking the father something like, "You do not want the children to suffer because of this divorce you wanted, do you, Mr Jones?" If he takes the bait, the follow-up questions might be: "And, you know how it would affect them if their lifestyle was substantially reduced?" "And, you know what that lifestyle costs?" "You've always been generous with them have not you?"

This concept may have a material effect on your negotiating strategy. In a fight over money, when they are not getting as much as they want, novice negotiators often react by accusing their opponent of being a skinflint or a cheapskate or by threatening him with going to trial if he does not loosen up. Although counter-intuitive, it may be much more effective to remind the skinflint of all of his generous past acts so that he will act consistently with a pattern of generosity.

The consistency principle can also be invoked in order to persuade an opponent to act consistently with established standards and norms.

Rule 5: Closure

Rule 5.1: Do not blow the end game.

Master negotiators know how to close. They consider every element of closure: when, where, documentation, pending issues. Novices either rush the end game or delay it interminably, with equally bad results. Rushing the end game usually means slapping a contract together with little time or thought. The resulting ambiguities and deficiencies inevitably result in disputes. Delaying the end game means failing to "strike when the iron is hot". If you wait long enough, something will happen to prevent closure. Time kills deals.

Rule 5.2: Strive for a "wise agreement".

Any Method of Negotiation may be fairly judged by three criteria:

- It should produce a wise agreement
- It should be efficient
- And it should improve or at least not damage the relationship between the parties

A wise agreement can be defined as one that meets the legitimate interests of each side to the extent possible, resolves the conflicting interests fairly, is durable, and takes community interests into account. Arguing over positions produces unwise agreements. As more attention is paid to positions, less attention is devoted to meeting the underlying concerns of the parties.

Rule 5.3: Pay attention to details, but don't sweat the small stuff.

Here, again, the middle way is the correct path. You can kill a deal by being too particular just like you can by delaying closure. Master negotiators are careful about closing, but they do not let petty issues prevent closing.

Do not fuss with minutiae. Let your counterpart take home some trinkets, even where both the leverage and the logic are on your side.

Rule 5.4: Do not neglect emotional closure.

Lawyers are great at analysing legal issues, negotiating agreements, and closing agreements concerning legal issues. But, in situations where people will have a relationship after they sign the agreement, they would be smart to make sure that they have tended to the emotional issues, otherwise, the legal agreement may suffer the consequences of any structure with a faulty foundation. Many times, especially in family disputes, agreements addressing emotional issues can be and should be, intricate and involved. But, remember, "An apology may be one of the least costly and most rewarding investments you can make".

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Complete the following formative assessment:

F13948.2 – Team Flowchart and Rulebook Presentation

Chapter 7
Practical Negotiation

"Favoured Outcome", "Settlement Point" and "Point beyond which you cannot go"

Before any negotiation, think of all the potential issues (variables) which might be discussed. For each issue identify:

- Your most favoured position
- Settlement point
- Point beyond which you cannot go

Do not forget to do the same for the other party. These three points must be decided when parties are preparing for the bargaining and in most cases during information exchange. Remember that at times the other party will not explicitly tell you their positions but you have to do your own research.

example

Negotiation scenario

Assume Ammy (manager at local government) and Thembi (chicks supplier) are negotiating for a contract in which the Department of Agriculture wants to buy 100 000 chicks for their rural poultry development programme. The Department is comfortable paying R 100,000 for the chicks and their budget has a tolerance of up to R 150,000. Ammy believes that if she pays only R 100,000 she can save R 50,000 to start a cattle rearing project for another village. On the other hand, Thembi is more comfortable selling the chicks at R 200,000 (100% profit) but she can come down to R 140,000 (10% profit). The two parties are seated for a negotiation to agree on the pricing together with the terms and conditions.

Explanation:

- The most favoured position for Ammy is R 100,000 and for Thembi it is R 200,000.
- "The point beyond which you cannot go" for Ammy is any amount more than R 150,000 and for Thembi it is less than R 140,000.
- Settlement point for Ammy and Thembi lies between R 140,000 and R 150,000.

Using the scenario of Ammy and Thembi above the following disadvantages can be identified:

Disadvantage to Thembi on Ammy's most favourable position:

- Thembi will not make a profit if she agrees to R 100,000. In fact, Thembi will make a loss.

Disadvantage to Ammy on Thembi's most favourable position:

- Ammy will have to go above her budget for poultry if she buys at R 200,000. In addition, it means she might fail to do other projects she was tasked to do by the government.

Disadvantage of Ammy's "point beyond which you cannot go":

- Thembi will not be able to get a maximum profit of 100% on the sales of chicks.

Disadvantage of Thembi's "point beyond which you cannot go":

- Ammy will not be able to save money to start a cattle-rearing project.

Anticipating Possible Points

Negotiators need to anticipate possible points from their counterparties. This is critical in order to brainstorm possible and concrete responses.

example

Negotiation scenario

Using the scenario of Ammy and Thembi the following points can be anticipated by either party.

Points Ammy can anticipate from Thembi:

Anticipated question	**Possible Response**
What method of payment shall be used?	Transfer payment to Thembi's bank account.
The time period for payment?	Total payment one month after delivery. We pay after assessing the quality of the chicks.
Is the contract once-off or continuous?	It is an on-going contract but we will be using different suppliers. So your contract will expire upon delivery of the chicks.
Who is going to bear the cost of transport?	The supplier must provide transport and the cost must be included in the purchase price.

Points Thembi can anticipate from Ammy:

Anticipated question	**Possible response**
What if the chicks die, do your chicks have any guarantee?	They are guaranteed for up to three days after delivery. The guarantee relates to the death of chicks as a result of poor incubation only.
Your figure is too high; remember we need to meet transport costs.	Transport cost is included. But if you want to provide transport we will deduct R 5,000 from the contract value.

Why are you charging us that amount?	Our costs of incubating are very high since we use a lot of electricity; our incubation system is expensive to maintain but it produces the best chicks in the country (check our list of satisfied customers).

Negotiation Structure

People, who are successful negotiators, always have a well thought-out strategy before entering into the negotiation, are well prepared, self-confident and structure the negotiation so that they remain in control of the negotiating process. The recommended structure for negotiations is:

- Establish the issues being negotiated
- Gather information
- Build a solution

Establish the Issues

Begin by agreeing on an agenda for the negotiation:

- What needs to be discussed and agreed?
- Who will be involved and what will be their role?
- What timescales are we working towards?
- What are the major issues that need to be agreed?

Many negotiators make the mistake of negotiating too quickly whereas skilled negotiators spend 20% more of their time asking questions and looking for alternatives. Do be aware that professional buyers will want to gain your commitment on issues, such as price, early on in the negotiation but you should never commit yourself to anything until you have established everything that is being negotiated.

Gather Information

This is a vital part of the negotiation and you need to remember that there are four kinds of information:

- Information you have that you are willing to give to the other side.
- Information you have that you are unwilling to give to the other side.
- Information the other side has that they are willing to give you.
- Information the other side has that they are unwilling to give you.

You need to decide, before the negotiation, how much you are willing to share information and what your own information requirements are. This will set the climate for the negotiation and will determine the amount of trust that exists between both parties. Skilled negotiators are able to ask a range of open, closed and follow-up questions and are able to listen effectively. They also wait until they have all their information requirements, before making concessions.

Build a Solution

Having gathered information the next stage is to begin to put together a solution. Usually, this will take the form of the selling side putting forward a proposal, or opening bid. The opening bid should be ambitious, but defensible. You should always challenge an opening bid and refuse to let an unacceptable bid stay on the table.

Typically, there will then be a process of bargaining, concessions will be traded and movement will take place, until, hopefully, agreement is reached. Concessions should not be given away for free and you should be wary about conceding on issues for which you are not prepared.

Presenting a Proposal for Negotiation

Before a team of negotiators begin the bargaining process they need to prepare a proposal that details what is and what is not on the table. The table below presents the basic contents of a proposal for a negotiation.

Basic contents of a negotiation proposal:

- A description of your capabilities or products
- A discussion of key issues
- A description of the buyer's specifications and how they will be met
- The cost of the offering
- A schedule for delivery of the products or services

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example

Basic Proposal

To:	Local government
From:	Thembi Poultry Suppliers
Description of the product:	100 000 day-old chicks (50 000 broilers and 50 000 layers)
Cost structure:	R 200,000 (R2 per day-old chick)
Inclusions on cost:	• Transport to local government offices • Insurance for goods in transit • Loading and offloading of chicks • Cost of the chicks • 2000L of pepsin • Support for 1 week • Replacement of chicks if death occurs within three days if linked to incubation.

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Exclusions:	• Transport to beneficiaries • Death of chicks due to negligence of beneficiaries.
Delivery date:	Within one day from agreement

Questions to Build Common Ground

Negotiators must be able to ask each other questions so as to:

- Build common ground and establish if there are any hidden agendas
- To clarify and seek explanation
- To test understanding

You need to ask the right questions at the right time. This also means you have to listen actively.

The following are the types of questions that can and should be asked:

Open-Ended Questions

These generally begin with "how; what, where, who?" They require a fuller answer than yes or no. They are used to:

- Gain information: What happens if I reduce the price?
- Explore thoughts, feelings, attitudes, and opinions: What is your view if we remove term number 5?
- Consider hypothetical situations and explore options: What are possible options for reducing the price?
- Why-questions are useful open questions, but can sometimes be less helpful if they sound too much as they are judgemental or seeking justification for action. In such circumstances they can sound moralising: Why did you do that?

Closed-Ended Questions

These invite a yes or no answer and may unhelpfully close down the options for responding. "Did you think of that possibility?" "Do you get on well?"

Repeated use of closed questions can take the discussion along a downward spiral of awkward communication with the counterparties in the negotiation saying less and less and giving pressure to ask more and more questions.

Closed-ended questions are useful as a questioning summary. For example, "So we have agreed that the contract price is R3 million payable in 12 equal instalments beginning in November 2017?"

Elaboration Questions

These may or may not be open questions, and are used to encourage the person to detail or fully explain what has already been said. For example; "Can you give me an example of a company that you have dealt with?" or "Can you say a little more about the warranty to your proposal?"

Leading Questions

These suggest that a particular answer is expected and there are particular beliefs or values that should be held. For example:

- Do you really think that the chicks can survive in this environment given the experience in Mahlanga district?
- Should not you be considering changing prices that are in line with the standard prices for houses?

Shared Interests and Opportunities for Cooperation

Contract law stipulates that prior to any agreement, the position of the negotiating parties is one of zero interest for all participants. There will be a stage when the parties choose to enter into an agreement because they have discovered that the other party has something of interest to offer - whether it be money in return for a set number of work hours a week or, two or more concessions to be traded.

As the negotiating parties overcome their zero interest positions and begin to pursue their interests, they need to determine exactly what will be discussed and what will not be discussed. This is frequently referred to as establishing common ground, finding a shared interest or shaping and framing. If common ground is not established, negotiations will be difficult and unfocused. Shared interests can be identified by following the steps below:

- Before or during the negotiations write down the key aspects of the negotiation that are important to you.
- Then do the same for the other party.
- Scan your list of interests as well as theirs and try to find points that are the same (shared interests).

example

Shared interests table

WANTS & INTERESTS (CIRCLE SHARED INTERESTS)	
WHAT'S IMPORTANT TO US?	WHAT'S IMPORTANT TO THEM?

Finding common ground normally occurs in the opening phases of a negotiation. The negotiating parties will devote time to flesh out what needs to be discussed, the location where it will be discussed and even where the parties will be seated. Simply put, if you are trying to find answers to questions such as:

- "Why are we here?"
- "What do we agree on?"
- "What is keeping us apart?"
- "When shall we deal with this?", then you are likely dealing with common ground in some form or other. Do not let this opportunity to find common ground slip away from you!

The following are some of the benefits of establishing common ground in a negotiation:

- Assists in developing a focus, and at the same time develops an atmosphere of certainty.
- It is much easier to maintain a focus on the real issues.
- This forms the nucleus from which solutions can be discovered.

Amending a Position

To a large extent negotiating is the art of knowing how to exchange concessions. One of the major drawbacks with this approach is that it can involve losses at two levels, both materially and from an image perspective. Concessions can become a way of life, eating away at an organisation's profit margin, particularly when sales targets are volume-based with little or no recourse to the bottom line. This is why it is important to plan carefully the concessions that you are willing to make. Here are some useful guidelines on how and when to offer movement.

Avoid Making the First Major Concession

It is important to work hard at not being the first party to make a major concession. The psychological victory gained by the winner of the first major movement is so important that it may shape the overall outcome of the talks. If you do find yourself in this unenviable position then try to obtain an equally important concession in return.

Offer Concessions in Reverse Priority Order

When the other side offers to make a concession they will usually expect you to make a concession in return.

It is important to have your concessions listed in reverse priority so that you can offer a concession of your choice before they can ask for something specific. Alternatively, you could opt to play "hardball" and accept their offer without responding in kind.

Make Every Concession Contingent

Frame every concession you make in terms of "If you agree to X, we'll give in on Y". If, however, the other side makes a contingent offer, you should aim to seek an advantage. For example, you could counter with an offer like "We'll accept X and Y but only if you agree to Z".

Behave as if Every Concession that you Make is Important

The other side will not usually know how much importance you attach to the concessions that you make. If you give the impression that a concession that you have traded is of no consequence to you, then the other side may push for further concessions before making a significant movement in their position.

When concessions are being traded, be wary of the negotiator who gives in too easily. They may be naive, they may know something that you do not or they may have misunderstood the consequences of agreeing to your demands. It is in both side's interests to make sure that the implications are fully understood before entering into a formal agreement.

Closing Negotiations

The closing of a negotiation represents the opportunity to capitalise on all of the work done in the earlier phases and needs to be handled carefully. There are a number of signs that indicate that the opportunity for closing negotiations is approaching:

- The difference in the position of the two parties narrows significantly.
- The objections and counter arguments have begun to fade. This may well indicate that all of the major points of contention have been addressed satisfactorily.

The other side indicates that they would like to see a draft final agreement or contract. This indicates they are willing to spend time examining the fine detail of the proposed deal.

When closing the negotiation you should be aware of the options available to the other side, the importance of the deal and the risks inherent in delaying, as well as those associated with putting pressure on the other side.

In a perfect world, the first draft of a contract would be acceptable to both parties, and life would resume with singing and dancing and no one would ever enter into a series of negotiation meetings. Unfortunately, however, this is not possible in the real world. Negotiators must be equipped with skills and tactics to bring a negotiation to closure or else it will continue forever. The following are some of the most important skills for negotiators when closing.

Negotiations continue right up until the deal is finalised, and in some cases, they continue even beyond that! You should be aware that the other side may try to pull a last minute tactical manoeuvre. This is often a last-ditch effort based on the premise that you have invested a lot of time and energy in the negotiations and are more likely to accommodate such a request, rather than jeopardise the whole deal.

The correct response to a last-minute demand will depend on the importance of the deal, the positions reached whilst bargaining, the state of the competition and the nature of the request.

If the other side makes a sudden announcement or shows an abrupt change of tactics, once the closing phase has started, it is important to remain calm. There is nothing to be gained by reacting with alarm, dismay or incredulity. Maintain a professional attitude and ensure that you understand all of the details of the change in their position.

When an agreement has been reached and the deal is signed, sealed and delivered there are a couple of important issues that still need to be addressed. You should try to manage both side's feelings of success. It is not a good idea to openly celebrate your skill in securing a deal that was beyond your wildest dreams.

There are different ways of closing a negotiation that negotiators can use. These include:

Stress the Positive Points

Reminding the other party of the benefits of the proposed contract will help put a positive spin on the deal itself, thereby lessening the chances of extensive negotiation. If you can consistently stress the positive points for the other party, they will see that they are getting a good deal and will sign faster.

Make One or Two Concessions

Face it: you are not going to get everything you want. But you can control what you get and what you lose by deciding in advance of negotiations to which you will concede. For example, if you know that the other party is going to contest the price, and you do not mind lowering it, get that out of the way first. The more you concede right from the start, the faster you'll close the contract negotiation.

Call it a "Courtesy"

If you are in the business of providing services, then you probably have a standard contract that you use for all of your clients. When you submit your contract to your client, explain that it is your standard agreement. If they come back and express the desire to negotiate, say something along the lines of, "Well, this is our standard contract, but as a professional courtesy, I'd be happy to hear your suggestions for negotiation". This immediately establishes that you do not have to negotiate, but that you will be happy to hear them out. This will probably keep their suggestion list short.

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Complete the following formative assessment:

F13948.3 – Team Roleplay and Key Notes

Chapter 8
Negotiation Strategies

Delaying Tactics

In the past quarter century, a great deal of effort and scholarship has been devoted to developing negotiation theory and practice to move beyond competitive negotiation and toward real problem-solving. All these past trends show us that strategies and tactics are crucial in negotiations.

The best negotiation strategies and tactics come from understanding the negotiation process and knowing how other people use negotiation strategies. This allows the person negotiating to watch out for tricks another person might use to convince him that he is wrong. Negotiation is about working a problem out so that both parties are happy, but it is still best to know tricks that others use to get their own way. Certain people are less willing to negotiate than others.

"Diplomacy is the art of saying 'Nice doggie' until you can find a rock." - Will Rogers

Sometimes in a negotiation, you might feel very strongly about the outcome but have not the strength to press for a satisfactory settlement through a competitive, compromising, or collaborative negotiating style at the moment. It is wise to delay the negotiation as you try to find your best feet in the settlement.

Accommodation-for-Now Tactic

In which case, you can use an accommodating-for-now approach to delay the negotiation. The way to use this tactic is to make it clear that, while you do not agree, you will go along with the other party for now – and discuss it again later on. Use wording like "for now" and "until I have time to look into it" or "it is okay for now, but I am not satisfied with it and we will have to go into it later."

Such phrasing makes it clear that you are using the accommodating-for-now tactic, and have reserved the right to negotiate later on. When you can find a rock.

Breaking a Deadlock

When a negotiation is trapped in a deadlock, both of the two sides are still trying to find out some methods to solve the problem, but neither of them can find the right way to continue their negotiation.

The following are the methods of breaking a deadlock:

- **Change the time of negotiation –** Suggest that you go on with your negotiation after lunch or dinner. A period of time for a stoppage can help both sides to readjust part of their subordinate principles.
- **Show compromise –** To mitigate the pressure on your opponents and show your compromise, you can let the member of your team who provokes the other side, leave.
- **Try to change the atmosphere in the conference room –** If the focal point which can benefit both sides is sunk to low-key, try to make it more competitive. If

the negotiation is hard to control, try to open more channels to reach two-sides winning.

- **Use concessions –** If the benefit brought by the implementation of cooperation is larger than the break of a negotiation caused by a deadlock insistence on original principles, then giving suitable concessions is the right tactic that you should take.
- **Off-table moderation –** Involves inviting a go-between (third party) who must have professional knowledge and high status, someone with much knowledge and who is powerful in the field under discussion. The third party will try and arbitrate the two sides and reach a compromise.
- **Shift from the negotiation issues –** Talk about your opponent's customs or an interesting story to ameliorate the tense atmosphere.
- **Highlight the consequences –** Explain the negative effects of the deadlock in the eyes of both parties. For example, time wasted, loss of potential revenue, effect on the public and the market.
- **Seeking similarity from differences –** When involved in a deadlock, we can try every possible means to find similarities while committing small differences. That is restating all the points that you have agreed on and this makes the parties involved feel that agreements can be reached.

General Negotiation Strategies

When doing business we do not have a choice as to whether or not we negotiate. The only choice we have is how well we negotiate. We all go through some sort of negotiation each day. We promote products, services and thoughts. Supervisors use negotiating skills to motivate employees and to set budgets and timelines. Employees negotiate for promotions and raises. Parents negotiate with their children to clean up and spouses negotiate each time they decide how to manage their time or finances.

Here are six important strategies that may be used for negotiations in business or life in general, but pertain especially to the negotiating process:

Continual Negotiation

Good negotiating outcomes are a result of good relationships and relationships must be developed over time. Because of that, good negotiators are constantly looking for opportunities to enhance the relationship and strengthen their position. In some cases, the result of the negotiation is determined even before the individuals meet for discussion.

Think Positive

Many negotiators underestimate themselves because they do not perceive the power they have inside of themselves accurately. In most negotiating situations, you have more power than you think. You must believe that the other party needs what you bring to the table as much as you want the negotiation to be a success. Also, be sure that that positivity is visible during the negotiation. Be aware of the tone of your voice and non-verbal body language while interacting with the other party.

Prepare

Information is crucial for negotiation. Research the history, past problems or any sensitive points of the other party. The more knowledge you have about the situation of the other party, the better position you will be in to negotiate. The most important part of preparation is practice! The study of negotiation is like golf or karate. You have to practice to execute well.

Consider the Best and Worst Outcomes

Consider the possible outcomes before the negotiations begin. Do not be upset if things do not go your way. In these instances, it is a good time to re-evaluate all positions and return to the table. In most cases, as long as you know the highest and lowest expectations of each party, a middle ground can usually be reached in the overlapping areas.

Be Articulate and Build Value

This is key, and it is what separates the good negotiators from the masters. When you have a strong belief in what you are negotiating for, you will shine. Become a master at presenting your thoughts and ideas so that others see the value.

A tip on how to do that well:

- Be direct when presenting a situation. Be clear about what is expected. Discuss ways to apply how it can happen.
- Do not simply talk about what needs to happen. Discuss the consequences – how your solution will be beneficial to the other party.

Give and Take

When a person gives something up or concedes on a part of a negotiation, always make sure to get something in return. Otherwise, you are conditioning the other party to ask for more while reducing your position and value. Maintaining a balance will establish that both parties are equal.

practical

Complete the following formative assessment:

F13948.4 – Team Brainstorming Session and Mind-Map Presentation

Section 2: References

Chevalier, D. 2012. Three Fundamental Reasons Why Negotiators Fail, http://www.negotiations.com/articles/negotiation-framework/

Noble, T. 2012. Improving negotiation skills: rules for Master Negotiators. http://corporate.findlaw.com/litigation-disputes/improving-negotiation-skills-rules-for-master-negotiators.html

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Section 2: Self-Assessment and Progress Check

Explain the need for negotiation skills in business.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Reasons why managers need negotiation skills are indicated with reference to the changing nature of the workplace and democratisation.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The kind of decisions that lower level managers are required to negotiate is identified with reference to the management structure of organisation and labour legislation.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Explain the steps in the negotiation process.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The steps used in negotiation are named and explained in terms of what is entailed at each step.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Reasons why negotiations fail are listed and an indication is given of what negotiators can do to facilitate a mutually satisfactory solution.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The abilities needed by skilled negotiators are identified and an indication is given of how each ability can contribute to the success or failure of a negotiation and at what stage of the negotiation each skill may be required.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Apply the steps in the negotiation process to an authentic work situation.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The concepts of "favoured outcome", "settlement point" and "point beyond which you cannot go" are explained for a selected scenario.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The disadvantages to each party for each position are considered prior to meeting.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment

Possible points that the other party might raise are anticipated and a possible response to each identified point is considered for the selected scenario.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
A proposal is presented and a clear indication is given of what is and what is not on the table for a selected scenario.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
A point-by-point summary of the proposal is compiled to ensure that both parties have a common understanding of the nature and extent of the proposal.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Questions are asked to build common ground and establish the existence of any hidden agendas.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Shared interests, opportunities for cooperation and common principles are identified in order to facilitate negotiation.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
A position is amended without sacrificing fundamental interests for a selected scenario.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Questions are asked for clarification and explanation.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Questions are asked to test understanding and to summarise understanding of a position.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Demands of the other party are analysed and a concession is proposed for a selected scenario.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The negotiation is closed for a selected scenario.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Explain strategies that could be used in negotiation.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment

Tactics that can be used to delay a negotiation are described with examples.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Methods that can be used to break a deadlock are explained with examples.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Different types of closure are identified and an indication is given of when each is suitable.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment

citrus academy
CRW

Section 3: Critical Reading and Comprehension in Business

Learning Goals and Pathways

In order to obtain finance and negotiate contracts, you will find it necessary to be able to read and comprehend business documents quickly and accurately.

This section will help you to practice critical reading and comprehension skills that will help you in your business communications.

This section is presented in the chapters 9-11 of the guide. Note that there are also a number of annexures at the end of section 1, which may be useful tools to help you in the process of seeking and obtaining business finance.

The learning goals for this module include:

1. Use a range of reading and viewing strategies to understand the literal meaning of specific texts.
2. Use strategies for extracting implicit messages in texts.
3. Respond to selected texts in a manner appropriate to the context.
4. Explore and explain how language structures and features may influence a reader / viewer.

Chapter 9
The Need for Critical Reading

Critically Analysing Texts

How can you learn to read and write better?

Reading is primary. One can write only as well as one reads.

Not all readers are writers. Many people read newspapers and novels and never write an original word themselves. They can decipher words and sentences on the page, but do not have a sufficient grasp of spelling and grammar to construct their own sentences. But all writers must be readers! You cannot write without reading as you write. You cannot write without first understanding how the language works to communicate ideas.

To write better, you must learn to read better. To consciously evaluate your writing you must become more conscious of reading behaviours. Finally, throughout your education and employment, you will be expected to read far more complicated texts than you are expected to write. Once again, reading is primary.

Improving Reading

To fully understand texts, both in terms of what they mean (as readers) and how they are constructed (as writers), you must read and discuss texts in a number of ways. Here we will look closely at three combinations of reading strategies and their respective forms of discussion or accountability:

- What a text says — restatement
- What a text does — description
- What a text means — interpretation

The chapters of this guide examine how to recognise each style of reading and discussion and when each form of discussion and reading style is most appropriate.

Different Ways of Reading for Different Occasions

Readers read in a variety of ways for a variety of purposes.

- They can read for information, sentence by sentence, taking each assertion as a fact.
- They can read for meaning, following an argument and weighing its logical and persuasive effects.

- They can read critically, evaluating unstated assumptions and biases, consciously identifying patterns of language and content and their interrelationships.

It is possible to read the same text differently for different purposes.

example

Reading the SA Fruit Journal

As part of your research into the viability of markets, you might read articles in the SA Fruit Journal for information and to get a broad understanding of current trade conditions.

On other occasions, you may read the same articles with the aim to research specific markets in order to compile a marketing strategy.

information

Genre of scripts and styles for reading purpose

Genre of scripts	**Descriptions**
Expository	A genre of writing that informs, describes or explains with text types that include: autobiography, biography, descriptive, essay, informational report, and media article.
Narrative	A genre of writing that entertains or tells a story with text types that include: adventure, fairy tale, fantasy, historical fiction, mystery, personal narrative, realistic fiction, and science fiction.
Persuasive	A genre of writing that attempts to convince readers to embrace a particular point of view with text types that include: advertisement, editorial, essay, political cartoon, pro / con, and review.
Procedural	A genre of writing that explains the instructions or directions for completing a task with text types that include: experiment, how to, and recipe.
Transactional	A genre of writing that serves as a communication of ideas and information between individuals with text types that include: blog, business letter, friendly email, friendly letter, interview, invitation, and postcard.

Ways to Read Particular Styles of Text

How you choose to read a particular text will depend on the nature of the text and your specific goals at the time.

example

Reading a contract document vs. an information leaflet from business partners

Organisations such as business partners or banks will produce both information leaflets and contract documents.

You will clearly read the information leaflets in a different manner to reading a contract document. Contract documents are factual and binding under the law. It is thus very important that you read and understand every word and paragraph of a contract.

Analysis and Inference: The Tools of Critical Reading

These tools are designed to take the mystery out of critical reading. They show you what to look for (analysis) and how to think about what you find (inference).

The first part —what to look for— involves recognising those aspects of a discussion that control the meaning.

The second part —how to think about what you find— involves the processes of inference, the interpretation of data from within the text.

Recall that critical reading assumes that each author offers a portrayal of the topic. Critical reading thus relies on an examination of those choices that any and all authors must make when framing a presentation: choices of content, language, and structure. Readers examine each of the three areas of choice and consider their effect on the meaning.

Evaluating Information

You should evaluate:

- When you first look for information in a catalogue or search engine
- When you have the information in your hand, or on the screen, and you are deciding whether it is usable.

Evaluation begins when you look for information and you are deciding whether it is worth walking upstairs to get a book off the shelf, or following a particular link on a web page. Doing this efficiently can save you a lot of time and effort.

Once you have a piece of information, you need to decide whether it can be used in your work and whether the information is reliable.

Interpreting Relevance

Before you start evaluating your resources, make sure that you know exactly what is required from you.

Some points to consider to help you to decide if a **book or periodical** (like a journal) is relevant:

- **Title** - Does the title indicate that the item is too specific or not specific enough? Is there a subtitle with more information?
- **Author(s)** - What are their credentials and reputation, are they associated with any institution or organisation?
- **Date of publication** - Is it recent enough for your work? Does it need to be recent at all?
- **Edition (books only) -** Multiple editions indicate the item is well-regarded enough to have been through revisions and has been updated.
- **Publisher** - Is it published by a recognised body?
- **Level** - Scholarly or popular? What audience is it directed towards?
- **Type of resource** - Have you been asked to find a particular type of resource (newspapers, websites, journal articles)?

Some points to consider to help you to decide if a **website** is relevant:

- **Title** - Does the title indicate that the item is too specific or not specific enough? Is there a description with more information?
- **Author(s)** - What are their credentials and reputation, are they associated with any institution or organisation?
- **Date of revision** - Is it recent enough for your topic? Does it need to be recent at all? Updates imply that changes have been made.
- **Owner of site** - Is it a government body (.gov in address), an academic institution (.edu or .ac) or a commercial body (.com)? Is it South African based (.co.za)?
- **Description** - Search engines obtain the description from the headings assigned by the page's author, or from the beginning of the page. Does it look relevant?
- **Type of resource** - Have you been asked to find a particular type of resource (e.g. newspapers, websites, journal articles)?

Confirming Currency

What to look for in books and periodicals.

Knowing when your material was published is very important when evaluating it. Topics in rapidly changing areas such as medicine, computing and technology often demand very current information which you find in recently published books, journal articles or on the internet.

In some subject areas such as art, history, or literature, information published 5 or 10 years ago is often just as valuable.

To decide how current your material is, look at:

- The publication date of the book or journal article
- The dates of the references listed in the book or article's bibliography
- The date that the web page was last updated

If you cannot find these dates, you will have to use other ways to evaluate the information.

Be aware that publication dates can be misleading:

- **Books** - It can take up to two years for a book to be published, so the information in a 2015 book may already be out of date. Some dates represent the year a book was republished (as a paperback, or after being out of print for some years).
- **Journals** - Journal articles are usually printed more quickly than books, but there can still be a delay of over a year (depending on the journal) before you see it.
- **Web pages -** Many are updated constantly, but there is no guarantee that the date given (if given at all) is accurate.

Judging Reliability

Quality publications will give you the author or the organisation that is responsible for the information. Be wary of any publications that do not give this information.

To decide whether your source is reliable, look for the following:

- Author's details - What is / are the author's qualifications or the organisation where he / she works?
- Details of the publisher
- Whether the journal is peer-reviewed or refereed, meaning that the articles are selected by experts in the same field
- Other works on the subject written by the same author
- Name of the organisation that supplied the information on the website -
  Is it an educational institution (.ac extension)? A government agency (.gov)? A commercial supplier (.com)? A non-profit organisation (.org)?

Interpreting Accuracy

It may be difficult to tell whether the information you are reading is correct if you are not familiar with the subject area. Here are some things to look for:

- **Details of the author or the organisation**. Some organisations such as Greenpeace will have their own point of view on political, economic or moral issues. Therefore, they may only give facts or statistics that support their point of view.
- **Are the sources of the facts given?** Does the statistics come from reliable sources such as the National Statistics website?
- **Does the information have a particular bias?** Does it promote the ideas of a particular group such as religious or political? Emotive or vague language often indicates only opinion, propaganda or marketing attempts rather than researched facts.

With web documents, look at the domain in the URL. This tells you whether the organisation is a college or university (.ac.), a government body (.gov), or commercial (.com). Government, university, or professional organisations may be more objective than a business wanting to sell products

Chapter 10
Reading and Understanding Formal Contracts

The Purpose of Business Contracts

Business contracts outline important agreements you (or your business) enter into with others. If you own a small business, you should familiarise yourself with writing a good agreement, or contract. Small business owners often operate on informal understandings that do not document or even completely verbalise to the other party. But if the agreement is important, it is worthwhile for you to take the time to draw up a formal contract.

So what constitutes an "important" agreement? Any agreement on which you are relying and that can affect the future of your business.

Contracts allow the parties the opportunity to:

- Clearly define their obligations to, and expectations of each other
- Limit their liability
- Lay out payment terms
- Divide up business risks
- Make sure each side understands its responsibilities

What makes a contract a contract? A valid contract typically requires the following four elements:

- A meeting of the minds between the parties demonstrating they both understand and agree on the essentials of the deal.
- Consideration (something of value exchanged by each of the parties, such as cash, goods, or a promise to do something).
- An agreement to enter into the contract (typically evidenced by both parties signing a written contract, although oral contracts can be valid, too, in some situations).
- The legal competence of each party, meaning the parties are not minors and are of sound mind.

Consensus in Understanding

It is important that you make sure that you and the other party to a contract understand and interpret the meaning of phrases and documents in the same way, otherwise, you are sure to end up in a legal dispute.

definition

Interpretation

It means to read and understand a specific piece of writing in a specific way.

The first step in creating a contract is making sure that both parties are talking about the same deal so that when they subsequently agree to enter into the contract they are both agreeing to the same thing. It might seem obvious, until you realise that the "vintage red car" you planned on buying from your brother-in-law is not the Ferrari, it is his Pinto. Take the time to communicate your understanding of the deal to the other party, and listen carefully when he or she talks back.

Confirming Consensus

After the parties reach a meeting of the minds regarding the deal, they must both exchange something of value in order to create a contract. Often, one party provides its goods or services in exchange for the cash of the other party. But consideration can take many other forms, as long as each party is giving up something of value to it to convince the other party to enter into the contract.

You can read law treatises defining consideration until the cows come home, but in the real world, your biggest issues related to consideration are how much and when.

If cash is exchanging hands in your contract, think through any assumptions you are making about the way payment will be made.

- If you expect to be paid at the time the contract is signed, say so.
- If one of the parties will be paying after the contract is signed, say whether the payment will be in cash, by cheque, or by electronic transfer. Be explicit about the way the money will change hands.
- If payments will be made over time or based on external factors, such as the amount of business done, you may need to define the payment schedule by using a formula. Keep the formula simple and feel free to put examples of how the formula works right in the body of the contract.
- If you have to use a complex royalty or another payment formula, test the formula with the other side to be sure you both understand it.

Agreement to Enter into the Contract

After both parties understand the deal and understand what type of consideration will be exchanged by each party, they are ready to form an agreement. Usually, the parties demonstrate that negotiations have ended and an agreement has been reached when the parties sign the contract unless it is an oral agreement.

The Need for Legal Competence or Advice

Be sure that the party you are working with is legally competent to enter into a contract. Otherwise, your signed contract may be void and worth nothing. Even if the other guy wears a lampshade on his head, he may be legally competent. But watch out for the following situations:

- Minors cannot enter into contracts without the additional signature of their parents or guardians. In most countries, a minor is a person under the age of 18.
- Persons lacking sound mind usually cannot enter into contracts because they lack the ability to understand what they are doing and to create a "meeting of the minds". Persons lacking sound mind generally are those who are mentally handicapped or

impaired by the use of drugs or alcohol to such an extent that they cannot understand the significance of their acts.

- Persons who lack authority to act on behalf of someone else may not be able to legally bind that other person or company. Always make sure that the person signing on behalf of a company or another person has the legal authority to do so.

practical

Complete the following formative assessment:

F119457.1 – Team Practice Worksheet

Chapter 11
Financial Information and Statistical Data

Financial statements are the report card of business. Whether you are a new investor, a small business owner, a manager, an executive, a non-profit director, or just trying to keep track of your personal finances, you need to understand how to read, analyse, and create financial statements so you can get a full and accurate understanding of how much money there is, how much debt is owed, the income coming in each month, and the expenses going out the door.

The Annual Report

Many investors know that they are supposed to request a company's annual report to understand the business but they do not really know what it is or why it is important.

What is the annual report?

The annual report is a document prepared by a company's management to the shareholders explaining what happened in the business for the year. There are no real rules for what an annual report contains. Some companies do not even prepare one.

information

Citrus Academy Annual Report

You can access a good example of an annual report by going to the Citrus Academy website www.citrusacademy.org.za.

Financial Statements

For every business, there are three important financial statements you must examine:

- The balance sheet
- The income statement
- The cash flow statement

The balance sheet tells investors how much money the company has, how much it owes, and what is left for the stockholders.

The cash flow statement is like the cheque account. It shows you where the money is spent.

The income statement is a record of the company's profitability. It tells you how much money a corporation made (or lost).

The Income Statement ("Profit and Loss" Statement)

The income statement shows the financial results of operations for a period of time. Think of it as a "diary" of what transpired in, for instance, a 12-month period ("Year Ended 2017"). From the income statement, one can determine the level of profit or loss because amounts received from selling goods and services and other items of income are matched against all the costs and expenses incurred in the delivery of these goods and services. The major elements of an income statement are:

- **Net Sales** – represents the primary source of money received by the business from its customers for goods sold or services rendered. The net sales item covers the amount received after taking into consideration returned goods and allowances for reduction of prices.
- **Cost of Sales and Operating Expenses** – all costs incurred in the factory (including depreciation) in order to convert raw materials into finished products.
- **Operating Profit** – net sales less all operating costs
- **Interest Income** – additional source of revenue from investments
- **Interest Expense** – interest paid to creditors
- **Provision for Income Tax –** amount of income tax due

The Balance Sheet

The balance sheet presents the financial position of a business as of a specific date, much like a "snapshot" ("As of December 2017"). It is a report on the financial resources (assets) available to the business to carry out its economic activities as well as claims (liabilities) against its resources. The difference between assets and liabilities is the owner's equity. This follows the fundamental accounting equation: Assets = Liabilities + Owner's Equity.

The main elements of the balance sheet are:

- **Assets** – economic resources of a business such as buildings, equipment, land, motor vehicles, amounts owed by customers (accounts receivable), patents and bank deposits.
- **Liabilities** – economic obligations to pay definite or reasonably certain amounts at a time in the future. They are claims against the business by creditors.
- **Owner's Equity** – residual interest of the owners in the business.

The specific elements of the balance sheet are:

- **Current Assets** – include cash and those assets which in the normal course of business will be turned into cash generally within a year from date of balance sheet. These consist of cash, marketable securities (or temporary investments), accounts receivable, inventories and prepaid expenses (payments made in advance, such as insurance, from which the business has not yet received benefits). Therefore, current assets are mostly working assets in the sense that they are constantly being converted to cash.
- **Fixed Assets** – also referred to as property, plant and equipment, these represent those assets not intended for sale that are used over and over again in order to manufacture the product, display it, warehouse it, transport it. Fixed assets generally consist of land, buildings, machinery, and office equipment.
- **Depreciation** – defined for accounting purposes as the decline in useful value of a fixed asset due to wear and tear from use and passage of time. Fixed assets may also suffer a decline in useful value from obsolescence because new inventions and more advanced technologies are introduced. The cost incurred

to acquire the property, plant and equipment must be spread over the expected useful life. The usual method used is straight-line depreciation. Land is not subject to depreciation.

- **Current Liabilities** – generally includes all debts that fall due in the coming year. Payments made on current debts generally come from a business's current assets.
- **Accounts Payable** – represents the amounts that the business owes to its regular business creditors from whom it has bought goods or services.
- **Notes Payable** – money owed to a bank or other lender (wherein a written promissory note has been given by the borrower).
- **Accrued Expenses Payable** – may include salaries and wages payable to employees, interest on funds borrowed from banks, insurance premiums and similar items. To the extent that the amounts owed are unpaid as of the balance sheet date, these expenses are grouped as a total under accrued expenses payable.
- **Income Taxes Payable** – amount of taxes owed and due
- **Long-term Liabilities** – debts due after one year from the date of the financial report

It would do well to prepare the income statement and the balance sheet on a regular basis to guide the entrepreneur on critical decisions that must be made with regard to the business. There are a number of technology solutions available to aid the entrepreneur in generating these financial reports.

Statistical Information

Entrepreneurs make decisions based on data in their daily lives and in the workplace. Reading charts and graphs, interpreting data, and making decisions based on the information are key skills to being a successful worker and an informed citizen. Being an informed citizen includes understanding statistics and probability as well. Entrepreneurs cannot make reasonable decisions unless they understand from where the statistics come.

Charts and graphs are essential in the workplace. Data from charts and graph are used to make decisions. Graph are useful tools in that they organise data so the information becomes clearer. This organised information can then be used to draw conclusions, to make decisions, or to influence others. Data is organised in a variety of fashions, from charts and graphs to computer-generated spreadsheets.

Data collection, analysis, and graphing are essential in the workplace. Many industries, manufacturing in particular, now use statistical control processes to monitor their processes in order to ensure quality products. Often the front line employee is required to collect the data used for charting the manufacturing process. Therefore, employees at all levels should be knowledgeable about and comfortable with using a variety of charts. As more and more quality teams, consisting of a variety of employees, are charged with the task of ensuring quality products, employees will need to have an understanding of probability and sampling.

There is also the need to have the ability to read and interpret statistical process control charts. Employers want everyone to understand quality. Any chart or graph that shows production uses statistics. Other forms of charting are also used in the workplace to make decisions as well as gauge accuracy.

Statistical knowledge is important in problem-solving and decision making. Entrepreneurs, often without realising it, make decisions, based on statistical information. It may be via the television, radio, or it may be through print materials. Statistical information is used to communicate information and sometimes influence others. Understanding the flood of statistical information allows entrepreneurs to make more informed decisions.

Graphs, tables, and statistics make data easier to understand. Entrepreneurs create graphs for clarity and understanding, for themselves and for others.

Sometimes seeing the data in chart form makes the decision-making process easier since the information is clearer. Even when charts and graph are not initiated by entrepreneurs, they do tend to make the information easier to digest. Charts and graphs are also used for record keeping such as spreadsheets and databases.

There is a concern for the lack of understanding and ability to read and interpret statistical information, including charts and graphs. There is also worry about use and misuse of statistical information. Transferability is hard for many entrepreneurs. To know a concept is one thing, but to be able to look at a table and understand and interpret it, is hard to do.

Entrepreneurs use charts, graphs, and statistical information in their roles as workers, parents, and citizens. As workers, entrepreneurs use data to monitor the quality of the products being made. They also make decisions based on the data. As citizens, entrepreneurs need to understand the data that they are continually being bombarded with.

example

Statistical data and graphs

Statistical data is normally presented in tables and graphs.

It is important to understand how to read simple graphs, in order to understand the information given.

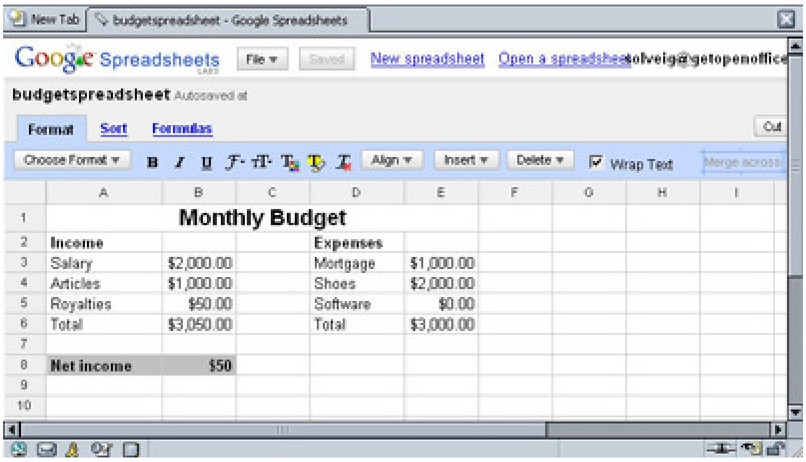
Data Visualisation

Data visualisation is a graphical representation of numerical data. The right data visualisation tool can present a complex data set in a way that is simple to understand.

Spreadsheets

A spreadsheet, which displays data in rows and columns, is very useful for displaying small data sets. When the data set gets too large, however, it can be difficult for the viewer to quickly grasp the relative significance of the data.

example

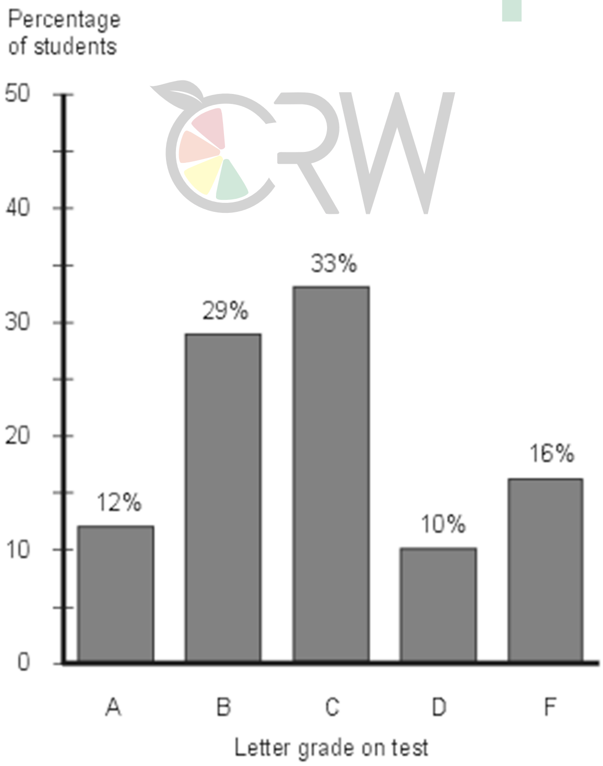


Monthly Budget				
Income			**Expenses**	
Salary	$2,000.00		Mortgage	$1,000.00
Articles	$1,000.00		Shoes	$2,000.00
Royalties	$50.00		Software	$0.00
Total	$3,050.00		Total	$3,000.00
Net income	$50			

Bar graphs

A bar graph is a pictorial rendition of statistical data in which the independent variable can attain only certain discrete values. The most common form of bar graph is the vertical bar graph, also called a column graph. Bar graphs can also be displayed horizontally.

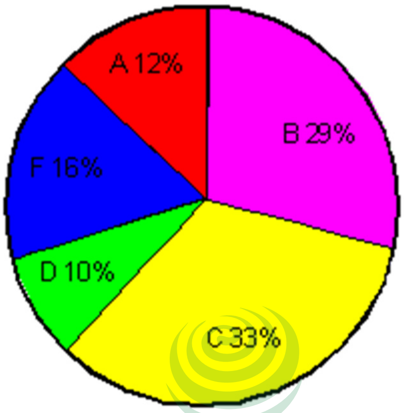
example



Pie chart

In a pie chart, the independent variable is plotted around a circle in either a clockwise or counter-clockwise direction. The dependent variable (usually a percentage) is rendered as an arc whose measure is proportional to the magnitude of the quantity. Each arc is depicted by constructing radial lines from its ends to the centre of the circle, creating a wedge-shaped "slice".

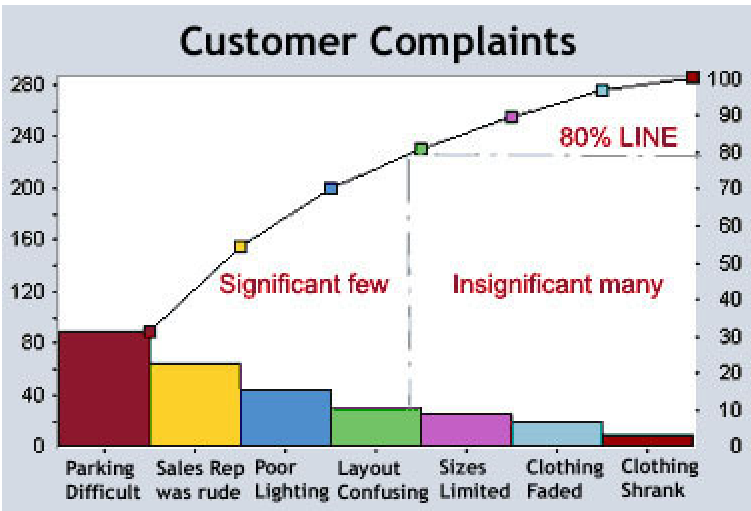
example



Pareto chart

A Pareto chart is a vertical bar graph in which values are plotted in decreasing order of relative frequency from left to right. Pareto charts are extremely useful for analysing what problems need attention first.

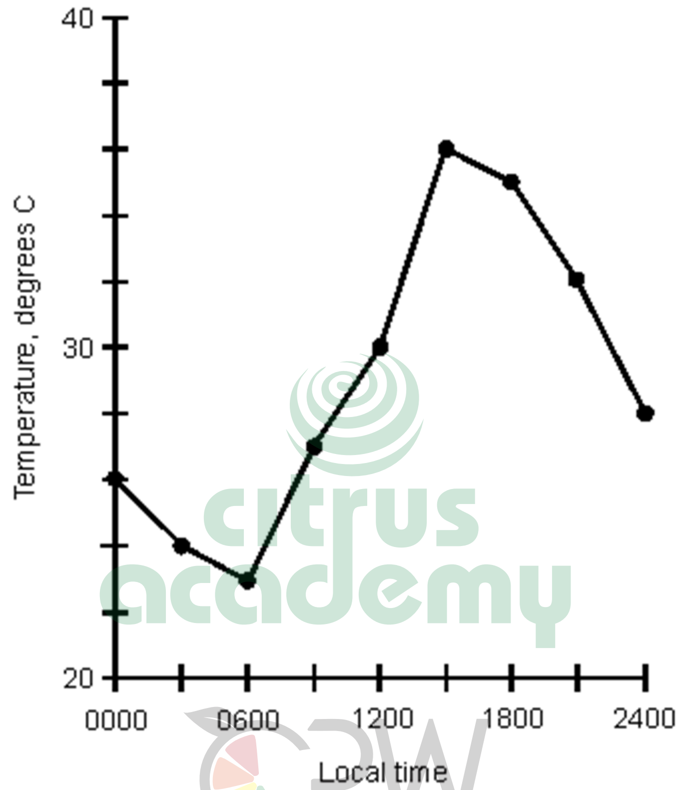
example



Fever chart

A fever chart is a graphical representation showing change of a variable over time. Fever charts, which are also called line graphs or point-by-point graphs, are useful for illustrating data that changes continuously, such as stock prices. Specific values of a function are plotted as dots on a coordinate plane.

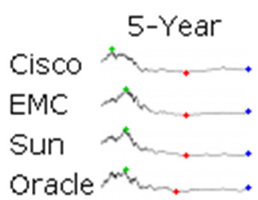
example



Sparkline

A sparkline is a small embedded line graph that illustrates a single trend. Sparklines, which are often used in reports, presentations, dashboards, and scoreboards, do not include axes or labels. Their context comes from the related content.

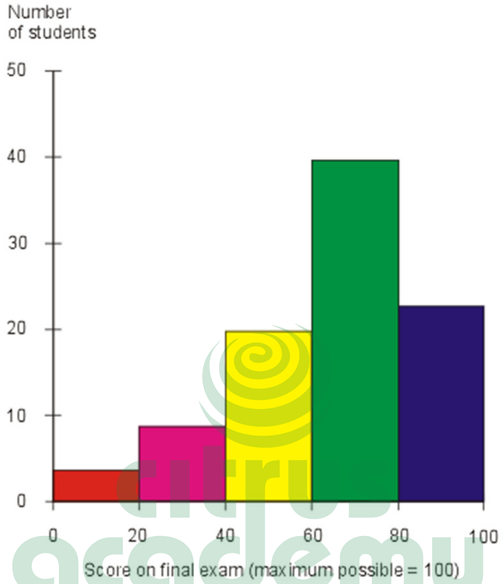
example



Histogram

A histogram uses rectangles to show the frequency of data items in successive numerical intervals of equal size. In the most common form of histogram, the independent variable is plotted along the horizontal axis and the dependent variable is plotted along the vertical axis. The data appears as coloured or shaded rectangles of variable area.

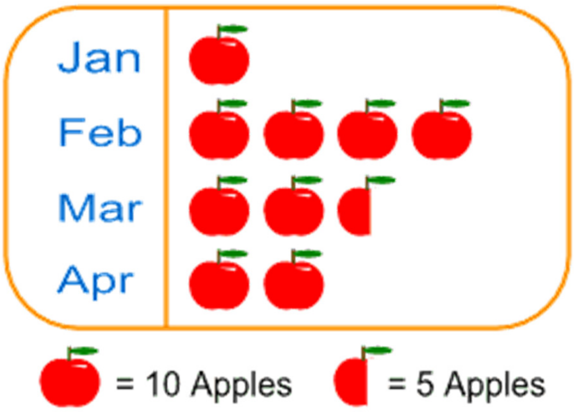
example



Pictograph

A pictograph uses picture symbols or icons to represent data sets. Pictographs are useful for illustrating simple data sets in an eye-catching manner.

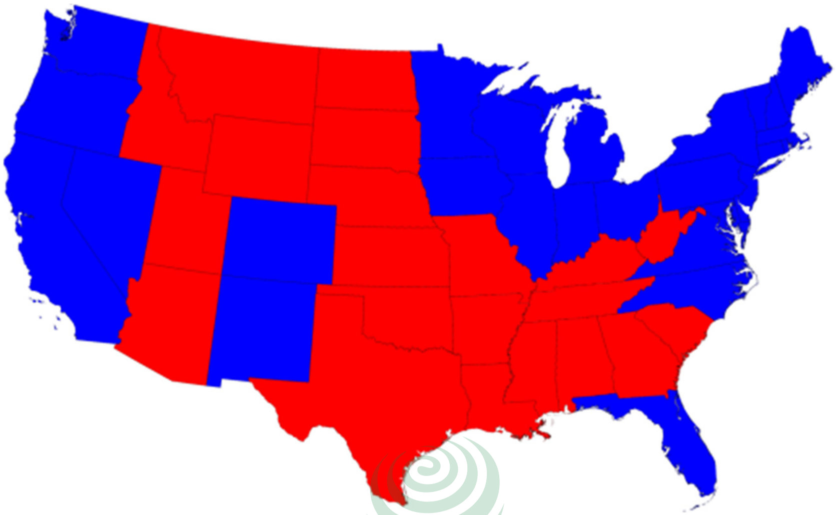
example



Heat map

A heat map is a two-dimensional representation of data in which values are represented by colours.

example



Dashboard

A dashboard, which somewhat resembles an automobile dashboard, displays key performance indicators.

example

practical

Complete the following formative assessment:

F119457.2 – Paired Work Sample

Section 3: Self-Assessment and Progress Check

Use a range of reading and / or viewing strategies to understand the literal meaning of specific texts.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Unfamiliar words / signs are identified. Their meanings are correctly determined by using knowledge of syntax, word-attack skills / sign parameter / analysis skills, and contextual clues.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Different options for the meanings of ambiguous words are tested, and selected meanings are correct in relation to the context.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Main ideas are separated from supporting evidence and paraphrased or summarised.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The purpose of visual and / or graphic representations in texts are recognised and explained.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Features of visual texts are explained in relation to the way they impact on meaning.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Use strategies for extracting implicit messages in texts.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Source of text is identified and discussed in terms of reliability and possible bias.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Attitudes, beliefs, and intentions are explored in order to determine the point of view expressed either directly or indirectly.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Techniques are explored and explained in terms of purpose and audience.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment

Respond to selected texts in a manner appropriate to the context.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Instructions and requests are acted upon.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Text-type, format, and register used are on the appropriate level of formality.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
Explore and explain how language structures and features may influence a reader / viewer.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment
The choice of words / signs, language usage, symbols, pictures and tone / sign, size and pace is described in terms of how a point of view is shaped or supported.	❒ I have the answer and am ready to start with assessment	❒ I am still not sure of this and am not ready to start assessment

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