Calculating Startup Costs

Introduction

Once you have developed a business idea and are ready to start a business, the next question is “how much money do I need to get started?”. This question is not as simple as it sounds to answer. Every industry and every business have unique cost requirements and expenses. Some industries require specific licensing, while others require particular certification assessments. Calculating the startup costs of a business requires planning and research to ensure you include all necessary expenses relevant to your line of business.

In this essay, we will look at five basic steps that can help you accurately calculate startup costs for your business.

Step 1: Define Cost Structure

The first step in calculating startup costs for your business is to define your cost structure. Your cost structure groups all of your business expenses and costs into categories that summarize your business. Below are examples of categories that can be used to group your expenses.

- Real estate expenses
- Sales expenses
- Professional fees
- Technology costs
- Administrative costs
- Sales and marketing costs
- Wages and benefits
- Inventory costs
- Working capital expense

Put some thought into what percentage of your funds will be allocated to each category. For example, a software consulting company will spend a significant chunk of its startup funds to buy software under the technology costs category, while a hair salon will spend a large amount of startup money on renting/buying a location under the real estate expenses category and paying wages for beauticians under the wages and benefits category. This activity will help you define the individual costs for each cost category. Remember that defining your individual cost line items within your cost structure will be a continuous activity as you progress through the next four steps.
Step 2: Conduct Research

After you define your basic cost structure, the next step is to conduct industry research for comparables. Most likely, you are not the first business to enter this industry. Use similar businesses to estimate your individual costs, for example, the percentage spent on office furniture versus employee wages. Remember to use companies in the same physical location and of the same size for an accurate estimate. Many times, large companies are able to get economies of scale due to their large volumes, so they may spend less on materials per product than your initial startup company in the same industry. However, you can still use these numbers as a goal to aim for in the future.

Comparables can be obtained from trade associations, industry leaders, entrepreneur forums, local business owners, government websites, and business groups. Do not be afraid to reach out to these organizations in search of their startup expenses and advice on getting started. Often times, local business owners can be the best source of information for estimating real business costs pertinent to your town, including unforeseen costs. The web contains masses of business forums and business groups for just about every industry possible. Use this resource to uncover the words of wisdom from other business owners in regards to startup costs for their business. Government websites, such as SBA and Census, also contain valuable information that is credible and free to access. Valuable information is available everywhere; you just have to be willing to seek it out.

Step 3: Be Conservative

The next step is to account for the unknown by being conservative. You should estimate cost projections conservatively in order to ensure your business can handle some bumps during the initial startup. Plan for the business to take some time before it is self-sustaining and profitable. A good rule of thumb is to add a 20% contingency to your startup costs. The contingency allows you a cushion for handling unforeseen items once you start your business.

Step 4: Account for Recurring Costs

It is vital that you account for recurring costs versus one-time costs when calculating startup costs for your business. Recurring costs happen month-after-month or year-after-year, such as rent, business insurance, and telephone service. On the other hand, one-time costs happen once, such as office furniture, office decor, and computer equipment. By understanding your fixed recurring costs, you can provide a more accurate budget required during the startup period. In addition, these recurring costs will help you distinguish between what costs are necessary and what costs are optional. Once your business is up and running and profitable, you can always allocate funds to buy non-essential items at that time.
Step 5: Identify Money Savings

Lastly, identify money savings for your startup business in the form of tax savings, government incentives, and loan deferment programs. There are lots of tax savings that you may qualify for during the initial startup period of your business. Many small businesses just starting out are eligible for tax savings including health insurance deductions, vehicle leasing or purchasing write-offs, and office furniture and supplies deductions. In addition to these tax savings, the government frequently provides tax incentives to small businesses for hiring new employees. Another way to help save money when starting up your business is to look for loan deferment programs. Many small business-lending institutions provide loan payback options that are deferred for six months to a year, allowing the business to become profitable before payments begin. The federal government provides procurement opportunities to small businesses that are located in a federally designated HUB Zone. Also, state tax credits are available to small businesses that are located in designated Urban and Rural Enterprise Zones. These money saving tips are only some of the options available to small businesses. You should research other programs and incentives available to small businesses in your town.

Summary

- Calculating startup costs for your business is not an easy task.
- Planning and research is necessary when calculating startup costs to ensure you include all industry specific and business requirement expenses.
- In order to accurately calculate startup costs for your business, follow these five basic steps:
  1. define your cost structure including individual cost line items and cost categories;
  2. conduct industry research for industry and business expense comparables;
  3. account for the unknown by being conservative in your numbers, and add a 20% contingency to your startup costs;
  4. account for recurring costs in order to create a more accurate budget for the startup period; and
  5. identify money savings for your startup business in the form of tax savings, government incentives, and loan deferment programs.